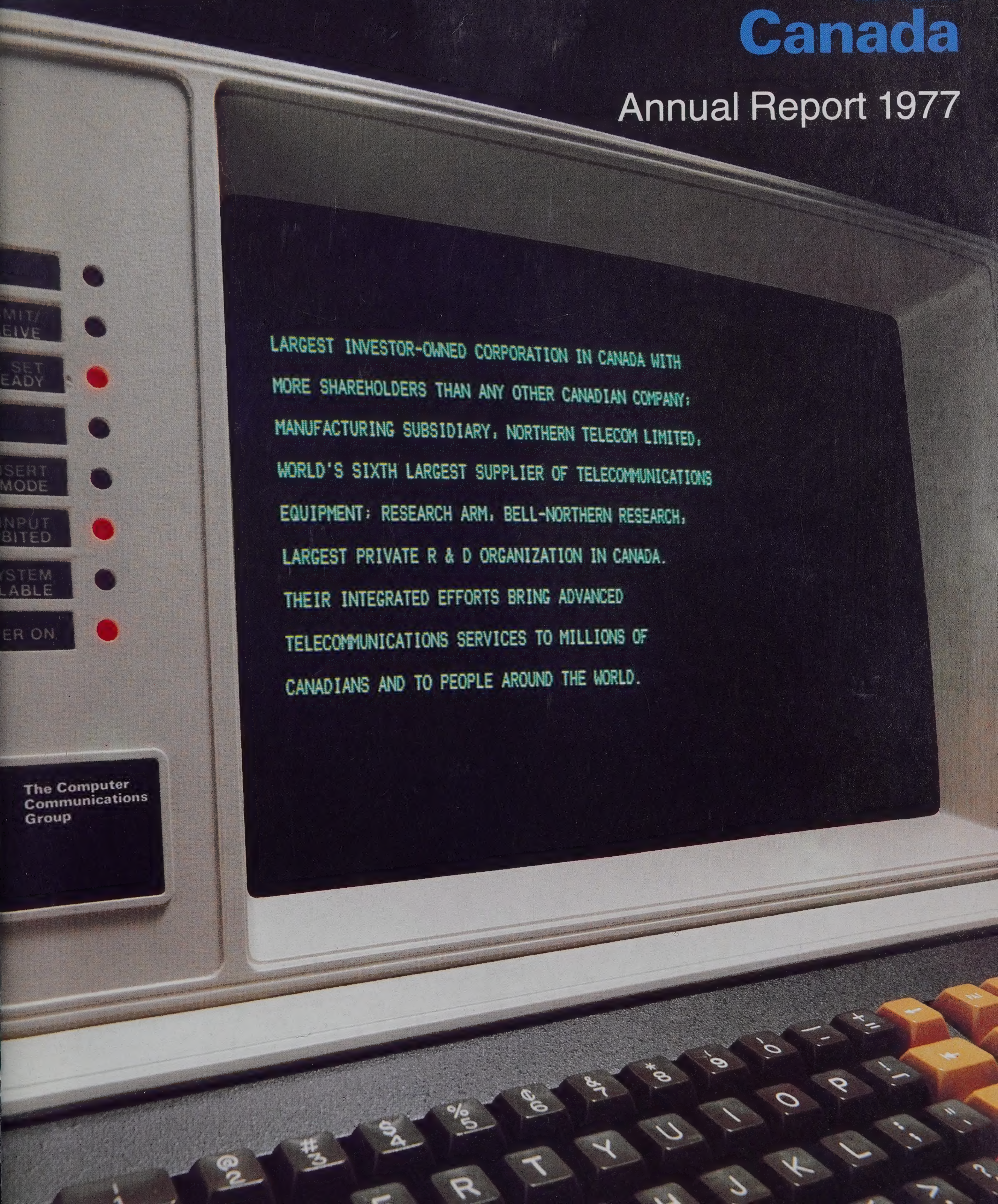
Bell Canada

Annual Report 1977



Corporate Information

Bell Canada
1050 Beaver Hall Hill
Montreal, Quebec
H3C 3G4

1978 Annual Meeting
The Annual General Meeting of the Shareholders will take place at 2:00 p.m., Tuesday, April 18, 1978 in The Great Hall, Hamilton Place, Hamilton, Ontario.

Trustee for Bonds
Canada Permanent Trust Company

Trustees for Debentures
The Royal Trust Company

Morgan Guaranty Trust
Company of New York

Transfer Offices for Bonds and Debentures
The Royal Trust Company
Montreal; Toronto;
St. John's, Nfld.; Halifax;
Charlottetown; Saint John, N.B.;
Winnipeg; Regina; Calgary;
Vancouver

Morgan Guaranty Trust
Company of New York,
New York, N.Y.
(For debentures issued in the United States)

Listing of Stock
Common Shares and Preferred Shares:

Canada
Montreal, Toronto, Vancouver Stock Exchanges

Common Shares:

Belgium
Brussels Stock Exchange
England
London Stock Exchange
France
Paris Stock Exchange
Germany
Frankfurt am Main, Dusseldorf Stock Exchanges
Switzerland
Zurich, Basle, Geneva Stock Exchanges
The Netherlands
Amsterdam Stock Exchange
United States
New York Stock Exchange

Transfer Offices for Stock
Company Offices —
1050 Beaver Hall Hill
Montreal
393 University Ave.
Toronto

The Royal Trust Company
St. John's, Nfld.; Halifax;
Charlottetown; Saint John, N.B.;
Winnipeg; Regina; Calgary;
Vancouver

Morgan Guaranty Trust
Company of New York,
New York, N.Y.
(For common shares only)

Registrar for Stock
Montreal Trust Company
Montreal; Toronto;
St. John's, Nfld.; Halifax;
Charlottetown; Saint John, N.B.;
Winnipeg; Regina; Calgary;
Vancouver

Morgan Guaranty Trust
Company of New York,
New York, N.Y.
(For common shares only)

The following publications are available to shareholders, without charge, upon written request to:
The Secretary
Bell Canada
1050 Beaver Hall Hill
Montreal, Quebec
H3C 3G4

Form 10-K
Bell Canada's Annual Report on Form 10-K as filed with the Securities and Exchange Commission in the United States.

Shareholder Dividend Reinvestment Plan
An outline of a dividend reinvestment and stock purchase plan provided by the Company for the benefit of common shareholders.

Annual Statistical Report
Intended for those desiring further data on our operations.

Bell Canada
Ninety-eighth Annual Report
Year ended December 31, 1977

Sur demande, le secrétaire vous fera volontiers parvenir un exemplaire français du rapport annuel.

Bell Canada
Consolidated

Financial Highlights

	1977	1976	% Change
Revenues (thousands of dollars)			
operating revenues	**$2,318,436**	$2,056,684	12.7
sales revenues	**$1,241,451**	$1,101,874	12.7
total	**$3,559,887**	$3,158,558	12.7
Income before extraordinary item (thousands of dollars)	**$ 286,208**	$ 287,384	(0.4)
per common share	**$ 5.98**	$ 6.45	(7.3)
assuming full conversion of convertible preferred shares and exercise of warrants	**$ 5.80**	$ 5.97	(2.8)
Dividends per common share	**$ 4.08**	$ 3.58	14.0
Equity per common share (at December 31)	**$57.56**	$56.53	1.8

Contents

Joining Canadians coast to coast.

Report of the Directors

Slow growth, high levels of unemployment, continuing inflation and political uncertainty characterized Canada's economic performance during 1977. These conditions had a negative impact on Bell Canada's operations and, despite continued high employee productivity, firm cost controls and increased telephone rates, our earnings were lower than anticipated. Nonetheless it was a year featuring many solid accomplishments for Bell Canada and its group of companies.

Financial Results
Consolidated earnings per common share were $6.04, compared to $6.50 in 1976, as a result of a decrease in the net income applicable to common shares and an increase in the number of common shares outstanding.

Earnings of Bell Canada, the regulated telephone company, were $4.73 per common share in 1977, compared to $5.23 in 1976, mainly as a result of a slowing in the growth rate of long distance and local service revenues throughout the year. Earnings from manufacturing and distribution activities increased from $1.33 to $1.39 per common share, as sales revenues increased to $1.2 billion.

The impact of the increased telephone rates which came into effect in Bell Canada territory on June 13 was diminished because of the slow rate of growth in local and long distance services during the year.

While the actual number of calls increased, the growth was below normal at 4.1 and 5.5 per cent for local and long distance calls respectively.

Expenses continued to increase mainly as a result of higher costs of wages, employee benefits and prices paid for goods and services. Maintenance and depreciation expenses were also up because of the growth in investment in new facilities.

Bell Canada's non-consolidated return on average common equity for the year was 9.02 per cent, well below the 12 per cent level the regulators have deemed acceptable.

For the sixth consecutive year, the dividend on common shares was increased. The April 15, 1977 quarterly dividend was raised to $1.02 — an indicated annual rate of $4.08, compared to $3.72 previously.

Capital Expenditures
Bell Canada invested $951 million in 1977 to build new facilities, modernize existing ones and replace obsolete or worn-out equipment. This included funds for an extensive program to provide and improve service in rural areas. The capital costs and related expenses of this four-year program will exceed $700 million by the time it is completed.

Total capital expenditures increased by 5.5 per cent over 1976 but were $58.9 million below original forecasts, as a result of the weaker-than-anticipated demand. The total would have been even lower had it not been for the continuing impact of inflation.

The bulk of the capital budget — $639.3 million, or 67.2 per cent — was spent to provide new service facilities and to relocate telephones for customers who moved. This kept Bell Canada installers busy in spite of the slow growth in demand in 1977.

Canadians seem to be increasingly on the move, because there has been a pronounced upturn in recent years in what telephone people call "churning". In 1977, Bell Canada connected 2.07 million telephones and disconnected 1.75 million to produce a net gain of 323,000 telephones. This means that approximately 12 telephones were moved for every new revenue-producing telephone added to the network. Last year the ratio was only nine to one.

In economic terms, churning is a drain on the Company's resources because installation rates are far from compensatory. The continuing increase in this kind of work, coupled with the fact that it represents a large part of Bell Canada's day-to-day operations, underlines the pressing need for more realistic rates. Other major factors that generate a continuing need for capital include the need to replace worn-out plant, to move plant as a result of public works and the need to improve the cost effectiveness of our services.

Financing
In order to meet service obligations, large sums of money were raised in the Canadian, United States and European markets during 1977.

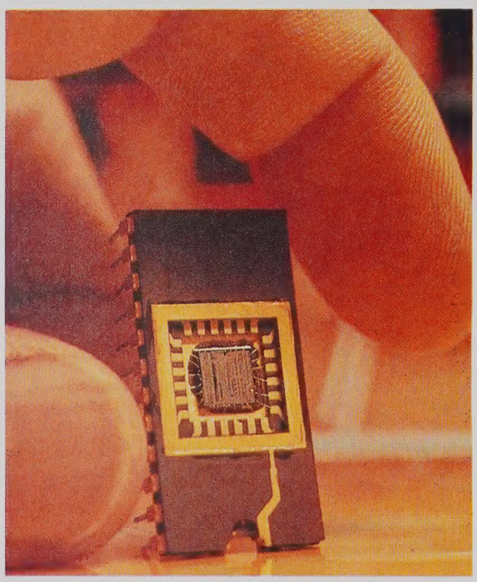
In February, $150 million of debentures were issued in Canada. The 9.40 per cent debentures, Series DC, were dated February 15, 1977 maturing on February 15, 2002, and were offered to the public at par. In late March, the Company announced its intention to issue U.S. $75 million of debentures in Europe, with an indicated coupon rate of eight per cent. Due to investor interest and demand, this was increased to U.S. $100 million at an interest rate of 7¾ per cent when actually marketed in April. These debentures, Series DD, were

Repair service is faster and more efficient for customers served by Bell Canada's new automated repair bureaus, first of their kind in the world. These computerized offices test telephones and telephone lines, and, by rapidly diagnosing problems, considerably reduce the overall time required to correct service difficulties.

issued at par and will mature May 1, 1987.

What is considered to be the largest common stock financing ever undertaken in Canada was concluded when over 99 per cent of the 2,625,000 warrants to purchase Bell Canada common shares at $46 were exercised by the expiry date of June 30, 1977. About $120 million was added to our equity base.

In December, the Company announced its intention to issue debentures in the United States market and, in early January, U.S. $200 million



Miniaturized integrated circuits containing thousands of transistors and their interconnections are, in effect, the brainpower of the new digital switching systems being produced by Northern Telecom.

were issued at par at an interest rate of nine per cent. The issue, Series DE, will mature January 15, 2008.

Late in the year, Bell Canada announced an improved Shareholder Dividend Reinvestment and Stock Purchase Plan to come into effect on January 1, 1978, for common shareholders. Shares purchased under the amended plan are newly issued common shares, rather than existing shares purchased on the open market. A major feature of the plan is that shares purchased with reinvested common share cash dividends are issued at a five per cent discount from the average market price as described in the plan. As of January 16, 1978, almost 10,000 additional common shareholders had joined the plan, bringing the number of participants to 11.5 per cent of all common shareholders.

Regulation

Of the $6 billion it will take over the next five years to meet the anticipated growth in customers' needs, nearly half must come from external financing. This is too much; more should be generated internally.

On November 3, 1976, Bell Canada applied to the Canadian Radio-television and Telecommunications Commission for higher rates that were designed to produce in 1977 a 12 per cent return on average common equity, if in effect from March 15. Following lengthy hearings, the CRTC approved most of the new rates, effective June 13, three months later than requested.

On February 1, 1978, the Company applied to the CRTC for approval of increased rates and of a higher permissive level of earnings in 1979 in the range of 13.5 to 14.5 per cent, which the Company believes is necessary to prudently finance the business. The Company asked for approval to implement the increased rates on July 15, 1978 in order to earn a 12 per cent return on average common equity in 1978.

Operating Environment

In common with many other businesses — both in Canada and elsewhere — Bell Canada each year becomes more and more occupied responding to actions or proposed actions by regulatory bodies, governments and government agencies.

In the last year alone, for example, the Company was involved in four major cases before the CRTC in addition to its rate application; was a party to the investigation into vertical integration in the telecommunications industry being carried on by the federal Restrictive Trade Practices Commission; and found it necessary to make representations on contemplated legislation which could seriously affect the Company's interests, in particular with regard to the proposed Telecommunications Act and the Competition Act.

A more constructive approach on the part of government would be action to stimulate employment and economic growth. A step in the right direction would be fair and equitable application of federal income tax. For example, Canada's manufacturing and processing industries currently incur federal income tax at a rate of 40 per cent; for the telecommunications industry the rate is 46 per cent.

In the telecommunications industry, the investment tax credit applies solely to research and development expenditures whereas in manufacturing, processing and other industries like mining, logging, oil and gas, it applies to prescribed buildings, machinery and equipment as well. In the United States, an investment tax credit is available to the telecommunications industry on its purchase of communications equipment. Furthermore, at 10 per cent the U.S. rate is at least double the generally applicable five per cent rate in Canada.

Operations Highlights

During 1977 a number of steps were undertaken to extend service and improve efficiency and productivity.

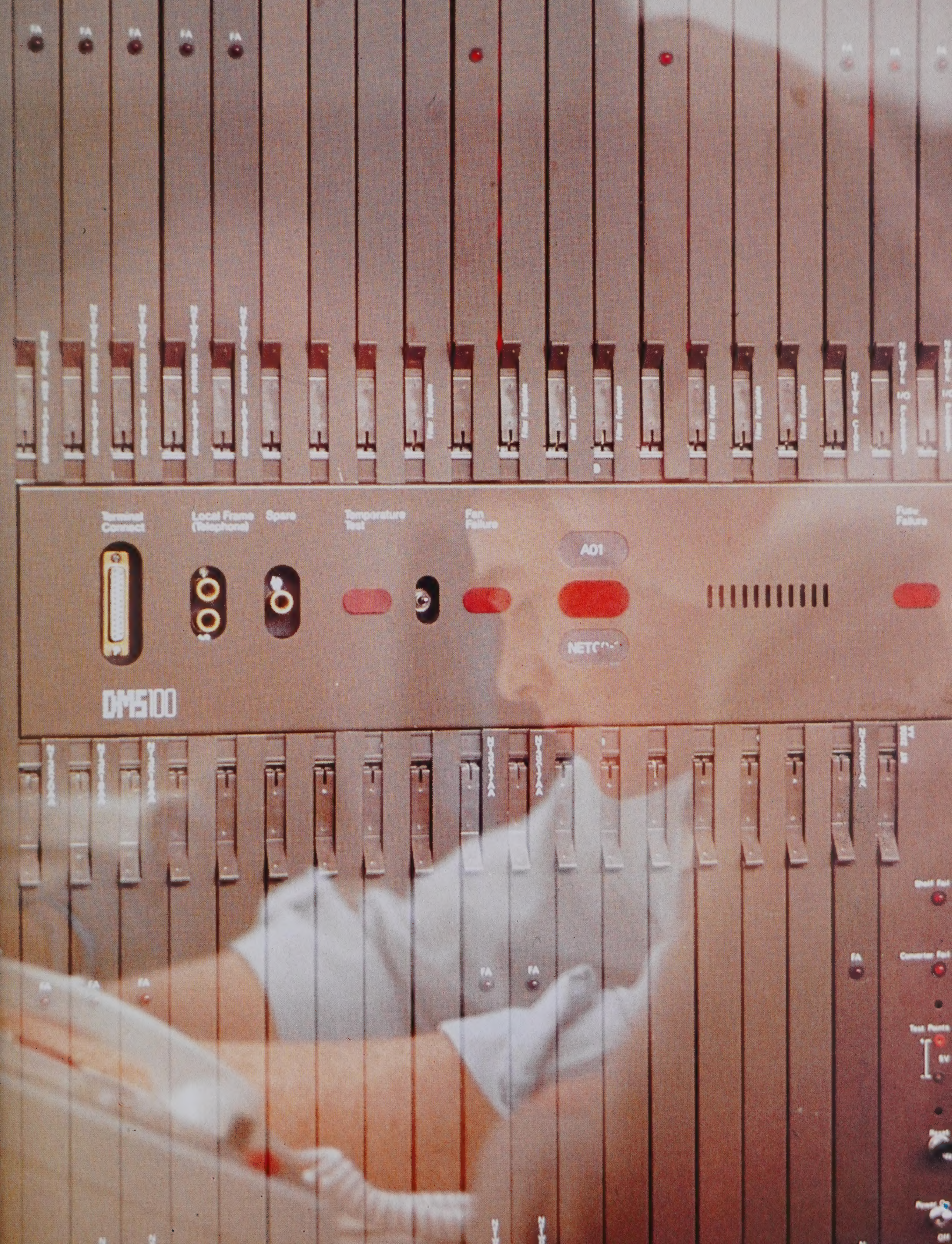
A massive program to improve non-urban telephone service was initiated during the year. The Company is committed to providing four-party service or better in all rural areas by the end of the four-year program.

In December direct dialing of station-to-station overseas calls was introduced in Bell Canada's territory. Many Bell Canada subscribers in Montreal and Quebec City are now able to call 27 countries without the aid of an operator. The service will be extended into Toronto and vicinity during the early part of 1978, and by 1980 such calls will be possible from most major Canadian cities. Also, in December, direct dialing to several Caribbean countries was introduced.

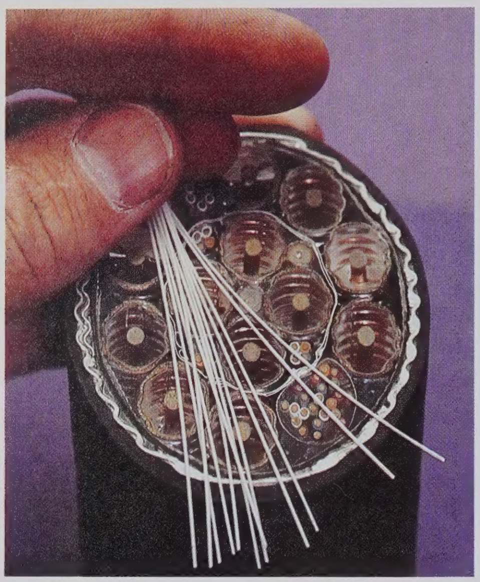
A new weekend discount plan for long distance calls also came into effect in June. The plan provides a uniform ⅔ discount from Saturday noon to Sunday at 6 p.m. for direct dialed calls within Bell Canada's service area. This provides a longer discount period and is helping to relieve the overloading of long distance circuits on Sunday.

The new Traffic Operator Position System (TOPS), which permits long distance calls to be handled more economically, was inaugurated in Toronto in February, 1978. TOPS allows customers to dial almost all their own calls and also provides operators with greatly improved working conditions. Further TOPS offices will be introduced in Bell Canada territory on a programmed basis.

The new DMS-100 central office local switching machine, capable of serving 100,000 lines, is currently undergoing field trials in Ottawa. This digital unit requires only one half the space occupied by equivalent electronic equipment, resulting in significant operating and capital cost savings.


Terminal Connect
Local Frame (Telephone)
Spare
Temperature Test
Fan Failure
A01
Fuse Failure
DMS100

In its continuing effort to improve service in the Northwest Territories, Bell Canada opened a new office in Frobisher Bay in June. The office employs native staff and serves 3,600 subscribers in 35 communities in the North. The Company has also launched a campaign to inform Inuit customers about the telephone system, utilizing a booklet in Inuktitut. During the year an order was placed for Telesat Canada equipment required to bring satellite service to the



These hair-thin glass fibres transmit as much information — television signals, data or telephone calls — as this cable. Bell Canada is a leader in developing and utilizing fibre optics technology.

six villages now served by high frequency radio. This project will be completed by 1980.

Two new computerized automated loop reporting systems (CALRS) were opened during 1977, in Hamilton and St. Lambert. This system for diagnosing telephone line trouble, developed jointly by Bell-Northern Research, Northern Telecom and Bell Canada and first introduced in Ottawa in 1976, is the world's first fully automated telephone repair service bureau and enables the Company to provide better service at lower costs.

Data Services

The Computer Communications Group continued to introduce innovations in 1977. In June one of the world's first packet-switched data networks — Datapac — became a commercial reality when it was placed in service across the country by the Trans-Canada Telephone System. Datapac is an "intelligent" public data network serving Canadians with coast-to-coast data transmission service. Datapac access services are designed to support the many types and makes of data terminating equipment commonly used in the industry today. Datapac has been linked with two packet networks in the United States, thus introducing international packet-switched services.

VUcom 4, a data communications terminal using cathode ray technology and specifically designed to meet the needs of business and industry for a basic visual-display teletype, was introduced during the year.

Dataroute, the world's first nationwide digital data transmission network on a commercial basis, was further expanded and now serves 36 communities across Canada.

Fibre Optics Developments

One of the fastest growing technologies in the telecommunications world and one with potential profit significance is fibre optics. Utilizing hair-thin glass fibres to carry information on laser light waves, fibre optics techniques promise to revolutionize many aspects of telecommunications systems. Bell-Northern Research has been a leader in researching this developing field.

In October a mile of fibre optics cable, designed by Bell-Northern Research and manufactured by Northern Telecom, was installed underground between two buildings in Montreal. In this field trial, some telephone conversations in the city are travelling along glass fibres instead of copper wires. The trial is designed to explore use of fibre optics technology under normal telecommunications network conditions.

Manufacturing

Northern Telecom's consolidated sales at $1.3 billion were 14.1 per cent higher than in 1976. Sales levels were maintained in the relatively soft Canadian economy and increased in the United States by 71.3 per cent. During 1977 telecommunications sales in the United States reached 18.1 per cent of total manufacturing sales, compared to 12.2 per cent in the previous year.

Ushering in a new era of digital technology, the first member of Northern Telecom's new generation of fully digital telecommunications switching systems was placed in service in October by a telephone company in Florida. The new system, known as DMS-10, is the first in a family of Digital Multiplex Systems that combine electronic stored program control with digital transmission techniques. It represents the most modern switching technology in the world.

Field trials of DMS-100 and DMS-200 — large-scale local and long distance switches — are under way in Ottawa.

The DMS family of products, developed by Bell-Northern Research, will be Bell Canada's primary vehicle for local and long distance growth and modernization throughout the 1980's. It is expected to prove popular with other telephone administrations around the world.

Saudi Arabia Contract

In December the government of the Kingdom of Saudi Arabia announced its decision to award a contract for extending and modernizing its telephone network to a consortium of companies comprising Bell Canada, Philips of the Netherlands and L. M. Ericsson of Sweden.

This is believed to be the largest single telecommunications project ever undertaken. Bell Canada's share of the gross proceeds is expected to be more than a billion dollars over a five-year period. Bell Canada-International Management, Research and Consulting Ltd. (BCI) will assist in carrying out the project, which will generate some 500 new jobs for Canadians.

Employee Relations

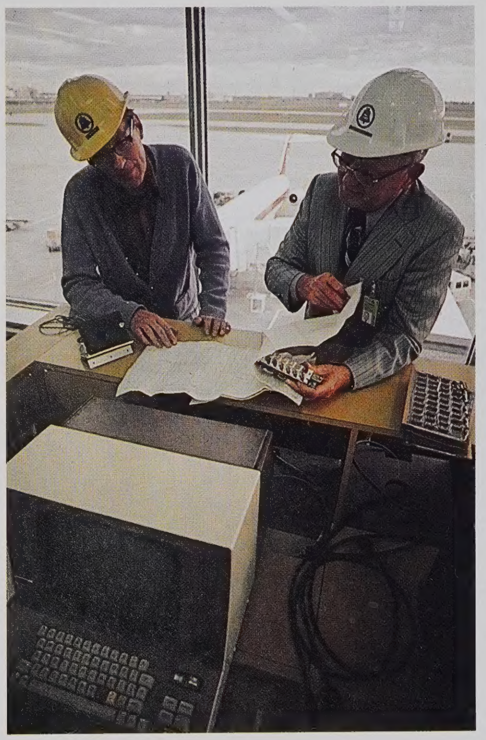
At December 31, Bell Canada had approximately 50,300 employees. Most of the 37,000 non-management employees were represented by one of three unions.

The Canadian Telephone Employee's Association, representing some 15,400 clerical and communications sales personnel, signed new one-year contracts in November, 1977.

Negotiations got under way late in the year with the Communications Workers of Canada with regard to wages applicable between December 1, 1977, and November 30, 1978. The

Work began in 1977 on one of the largest single undertakings in the Company's history: a four-year program to provide and improve non-urban service at a cost of more than $700 million in capital and related expenses. Hauling cable over rough terrain in the Muskoka lakeland region of Ontario is illustrative of the challenges facing thousands of employees working on hundreds of rural projects.


Bell Canada



Specialized telecommunications systems, such as the complex ground communications system at Malton International Airport near Toronto, are developed and installed to meet unusual customer requirements.

CWC represents approximately 14,000 craft and services employees.

Negotiations were also undertaken late in the year with the Communications Union Canada — representing about 7,800 operators and dining service employees — for adjustments to wages to be effective between November 25, 1977, and November 24, 1978.

All negotiated settlements are subject to review under Canada's Anti-Inflation Act.

Director Changes

W. M. Vacy Ash retired from the Board of Directors in April following more than ten years of conscientious and valued service to the Company. Elected at the last Annual Meeting to succeed Mr. Ash was J. Dean Muncaster of Toronto, President of Canadian Tire Corporation, Limited.

John C. Lobb, a Director of Bell Canada since October 1973 and past Chairman of Northern Telecom Inc., withdrew from the Board at the year's end and was succeeded by Robert J. Richardson, Sc.D., of Greenville, Delaware, Vice-President — Finance of E. I. du Pont de Nemours & Company and Chairman of Du Pont of Canada, who was appointed a Director with effect from January 1, 1978.

Outlook

In looking ahead to 1978, some positive developments may be hoped for. The general level of the economy is expected to improve. The phasing out of anti-inflation legislation and the prospect of a budget that would stimulate capital investment and increase employment should encourage business activity.

While such improvements are expected to support Bell Canada's revenues, favorable rate action is essential if Bell Canada is to continue to meet its obligations to its customers, employees and shareholders.

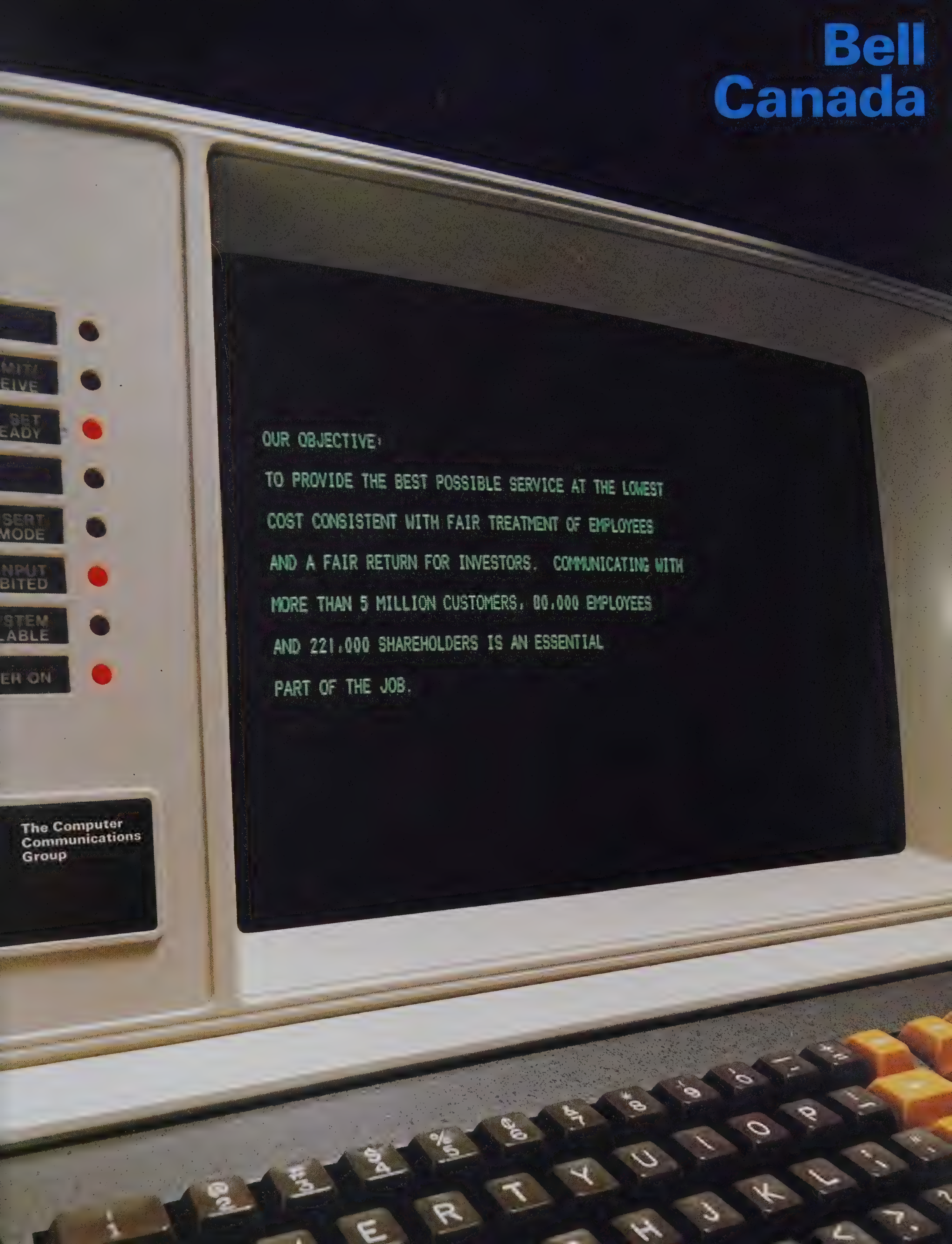
Undoubtedly your Company faces a challenging year in 1978. The men and women of Bell Canada are ready, as in the past, to respond vigorously and, we are confident, successfully.

For the Board of Directors,

Chairman

President

February 22, 1978


Bell
Canada
OUR OBJECTIVE:
TO PROVIDE THE BEST POSSIBLE SERVICE AT THE LOWEST
COST CONSISTENT WITH FAIR TREATMENT OF EMPLOYEES
AND A FAIR RETURN FOR INVESTORS. COMMUNICATING WITH
MORE THAN 5 MILLION CUSTOMERS, 00,000 EMPLOYEES
AND 221,000 SHAREHOLDERS IS AN ESSENTIAL
PART OF THE JOB.
The Computer
Communications
Group

Chairman A. J. de Grandpré discusses Bell Canada with a group of Europe's leading institutional investment analysts and portfolio managers at a conference in London, England.

. . . to inform and be informed.

- some 280,000 individual telephone customers, representative of Bell Canada's 5,000,000 subscribers, were surveyed by telephone, letter or in person during the year.

- in 1977 more than 1,000 Bell Canada middle and senior management people, in groups of 35 to 40, met with executive officers in a series of 37 three-day seminars to discuss major issues facing the business.

- in more than a dozen international financial centres in Canada, the United States and overseas, Bell Canada's top corporate and financial officers met with security analysts, research directors, securities sales personnel, individual shareholders and large institutional investors during 1977.

- in September, all Bell Canada shareholders and employees received a copy of "The Public Interest and Bell Canada", describing the benefits of vertical integration of the Bell Canada, Northern Telecom, Bell-Northern Research team.

Purpose: to inform and be informed.

These two-way communications are essential for Bell Canada management to obtain the information and understanding required to achieve the Company's basic objective: to provide the best possible service at the lowest possible price while maintaining fair treatment of employees and a fair return for investors.

Bell Canada's customers

For customers, the best communications are surely good services at reasonable cost. Internal and industry measurements show that the quality of Bell Canada service and the price at which it is provided can stand comparison with that of any other country in the world. But how do our customers themselves see it? Do particular procedures annoy them? Could certain aspects of service be improved? Are there new products or services that would meet needs that are important to them? Are charges seen as reasonable? Does Bell Canada play an appropriate role in the community?

It is to answer these questions — and many others — that Bell Canada carries out continuing customer surveys. With the information obtained, the Company is better able to tailor its facilities and services to the needs and interests of consumers.

In 1977, 91 per cent of Bell Canada customers felt that the quality of telephone service was good to excellent and over 80 per cent felt that the cost of service was reasonable to very reasonable.

Communications with customers are carried out daily in a multitude of ways — by telephone, in writing, through personal contacts and by advertising and informational activities.

Bell Canada's employees

Well-motivated and skilled employees are essential in meeting our Company objectives.

Of critical importance to the ability of employees to fully contribute to the future of the enterprise is the degree to which they are kept informed and enabled to understand the increasingly complicated issues with which the business is confronted and how the various Company functions inter-relate in dealing with them.

To meet this need Bell Canada held a series of Corporate Issues Seminars in 1977-78. Through thorough and frank two-way discussion, middle and senior management people were kept in touch with significant developments relating to financing, budgeting, regulation, organization, labour rela-

New products, such as this phone, are a response to careful and continuing market research — an important form of communications with our customers.

President J. C. Thackray discusses corporate objectives and directions at one of a series of Corporate Issues Seminars for management.

tions, planning and personnel, and other corporate concerns. Top corporate officers were at the same time alerted to managers' key interests.

While considerable management time was involved, analysis of the results indicates a marked success in achieving the basic objective. A similar program for junior management will be implemented during 1978.

Bell Canada's investors

Of particular importance to Bell Canada are its communications with existing and potential shareholders and institutional investors.

Holders of Bell Canada common and preferred shares number 221,000. So that they may know how their investment is performing, regular reports are sent to them quarterly.

In addition, should circumstances warrant, special communications are directed to shareholders and to the investment community. Last year, for instance, a reprint of remarks made by Company executives to the Toronto Society of Financial Analysts was distributed.

Under special circumstances, when the Company thinks that a matter is of critical long term importance, all shareholders and employees are informed. Such was the case with vertical integration, and a booklet, titled "The Public Interest and Bell Canada" discussing the advantages of integration in telecommunications was distributed to shareholders and employees.

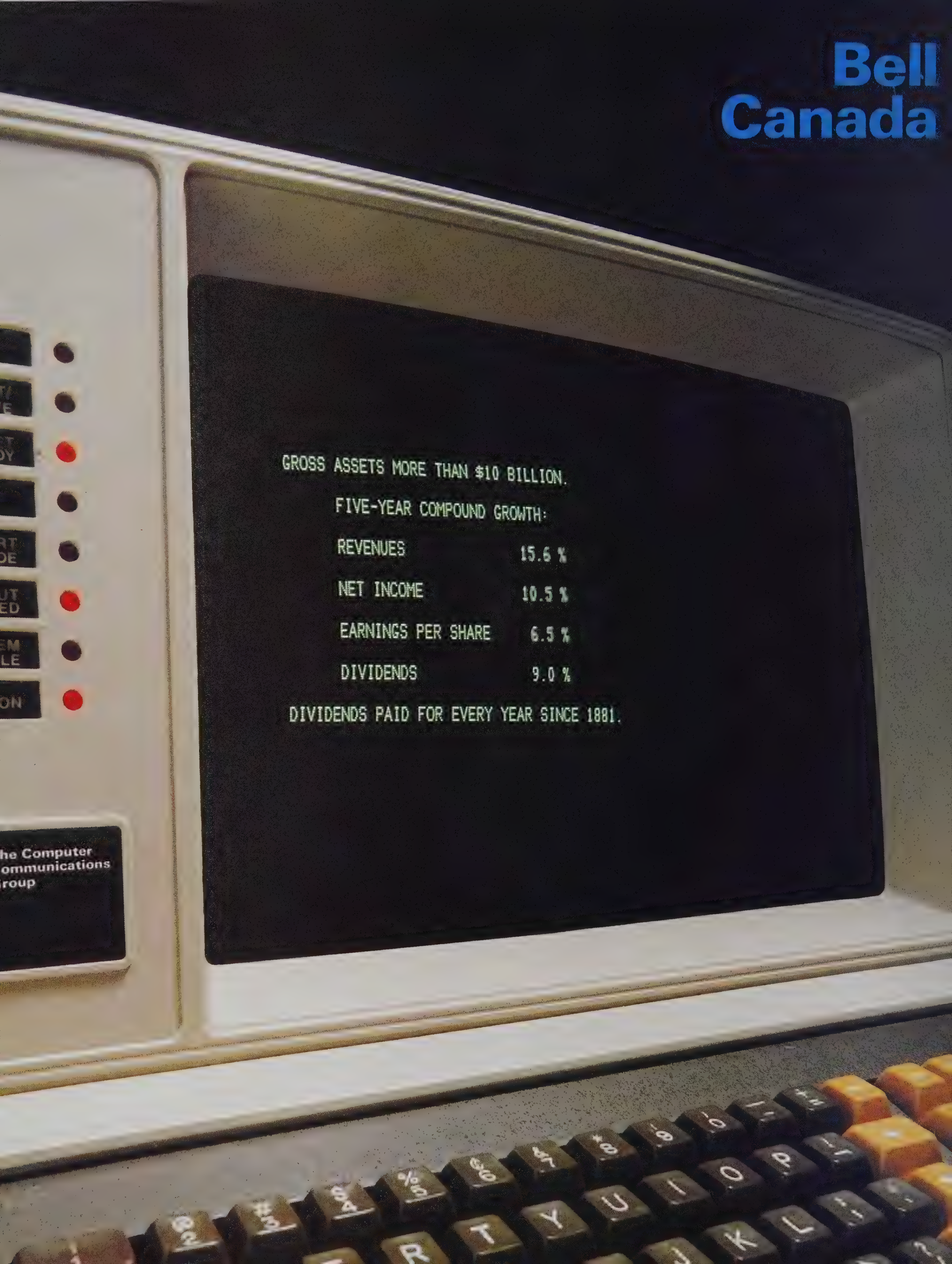
Annual meetings are another means of communicating with shareholders. To allow more shareholders the opportunity to attend, recent meetings have been held in Montreal, Toronto and Ottawa, with this year's meeting scheduled for Hamilton, Ontario. Along with civic and community leaders, shareholders living in the Kitchener-Waterloo area attended a "Meet Bell Canada" night last year. Similar events are being considered for selected communities in the future.

Communications with potential investors are also important. Bell Canada must raise about half a billion dollars each year from external sources to support the massive capital program required to maintain, extend and modernize the telecommunications facilities demanded by residence and business customers. To obtain money on favorable terms, the Company must ensure that current and potential investors are aware of the Company's performance and prospects. It must also be able to meet the criteria investors employ in deciding where amongst competing opportunities to invest their funds.

It is for this reason that Bell Canada carried on its extensive program of communications, and visits, to the international financial centres. These contacts are particularly important now that Bell Canada has broadened its access to capital markets to include the United States and Europe.

Some measure of the effectiveness of this program can be gauged by the fact that, since February, 1977, Bell Canada has raised $450 million through debentures and $120 million in equity in Canada, Europe and the United States.

In the final analysis, good service at a fair price is the best form of communications with our customers. Our employees direct their every effort toward achieving this objective.


Bell Canada
GROSS ASSETS MORE THAN $10 BILLION.
FIVE-YEAR COMPOUND GROWTH:
REVENUES 15.6 %
NET INCOME 10.5 %
EARNINGS PER SHARE 6.5 %
DIVIDENDS 9.0 %
DIVIDENDS PAID FOR EVERY YEAR SINCE 1881.
The Computer Communications Group

Consolidated Income Statement

	(thousands of dollars) Year 1977	Year 1976†
Operating revenues		
Local service	**$1,151,763**	$1,028,520
Long distance service	**1,031,553**	918,745
Miscellaneous — net	**135,120**	109,419
Total operating revenues	**2,318,436**	2,056,684
Operating expenses	**1,708,534**	1,479,379
Net operating revenues	**609,902**	577,305
Sales revenues — manufacturing and distributing	**1,241,451**	1,101,874
Less: Cost of sales	**874,265**	789,061
Selling, general, administrative and other expenses	**229,079**	183,582
	1,103,344	972,643
Net sales revenues	**138,107**	129,231
Total net revenues	**748,009**	706,536
Other income		
Interest charged to construction	**16,193**	15,559
Equity in net income of associated companies (note 3)	**13,094**	11,705
Miscellaneous	**13,403**	29,296
Total other income	**42,690**	56,560
Income before underlisted items	**790,699**	763,096
Interest charges		
Interest on long term debt	**213,371**	185,918
Other interest	**8,454**	10,378
Total interest charges	**221,825**	196,296
Income before income taxes, minority interest and extraordinary item	**568,874**	566,800
Income taxes (note 4)	**249,334**	251,645
Income before minority interest and extraordinary item	**319,540**	315,155
Minority interest	**33,332**	27,771
Income before extraordinary item	**286,208**	287,384
Extraordinary item (note 5)	**2,367**	2,188
Net income (note 16)	**288,575**	289,572
Dividends on preferred shares	**31,534**	28,847
Net income applicable to common shares	**$ 257,041**	$ 260,725
Earnings per common share* (note 6)		
— before extraordinary item	**$5.98**	$6.45
— extraordinary item	**$0.06**	$0.05
— after extraordinary item	**$6.04**	$6.50
Assuming full conversion of convertible preferred shares and exercise of warrants		
— before extraordinary item	**$5.80**	$5.97
— extraordinary item	**$0.05**	$0.04
— after extraordinary item	**$5.85**	$6.01
Dividends declared per common share	**$4.08**	$3.58
*Based on average common shares outstanding (thousands)	**42,554**	40,106

†*Restated — see note 2.*

Bell Canada
and Subsidiary Companies

Consolidated Balance Sheet

Assets

	(thousands of dollars)	
	December 31 1977	December 31 1976†
Telecommunication property — at cost (note 7)		
Buildings, plant and equipment	**$8,068,746**	$7,218,960
Less: Accumulated depreciation	**2,372,364**	2,109,722
	5,696,382	5,109,238
Land	**56,618**	52,406
Plant under construction	**212,843**	253,936
Material and supplies	**102,807**	105,103
	6,068,650	5,520,683
Manufacturing and distributing property — at cost (note 7)		
Buildings, plant and equipment	**387,506**	359,527
Less: Accumulated depreciation	**209,494**	195,088
	178,012	164,439
Land	**11,907**	10,782
	189,919	175,221
	6,258,569	5,695,904
Investments		
Associated companies — at equity (note 1)	**143,852**	105,825
Other	**2,346**	2,245
	146,198	108,070
Current assets		
Cash and temporary cash investments — at cost (approximates market)	**128,846**	194,893
Accounts receivable — principally from customers (including $2,623 (1976 - $5,224) from associated companies)	**462,776**	376,394
Inventories (note 8)	**225,467**	227,470
Other (principally prepaid expenses)	**55,160**	50,627
	872,249	849,384
Deferred charges	**53,678**	53,637
Total assets	**$7,330,694**	$6,706,995

On behalf of the Board of Directors:

Paul H. Leman, Director

Marcel Bélanger, Director

Liabilities and Shareholders' Equity

	(thousands of dollars)	
	December 31 1977	December 31 1976†
Shareholders' equity		
Capital stock (note 9)		
Preferred shares	**$ 356,492**	$ 376,997
Common shares	**1,094,008**	1,015,509
Premium on capital stock	**527,143**	460,878
Contributed surplus	**15,290**	15,290
Retained earnings	**882,537**	804,750
	2,875,470	2,673,424
Minority interest in subsidiary companies		
Preferred shares	**31,543**	20,741
Common shares	**163,914**	140,402
	195,457	161,143
Long term debt (note 10)	**2,679,867**	2,471,184
Current liabilities		
Accounts payable	**353,769**	310,041
Advance billing for service	**42,630**	37,461
Dividends payable	**50,213**	43,533
Taxes accrued	**26,136**	37,012
Interest accrued	**56,161**	45,332
Debt due within one year (note 11)	**195,641**	191,367
	724,550	664,746
Deferred credits		
Income taxes	**833,574**	717,472
Other	**21,776**	19,026
	855,350	736,498
Commitments (note 7)		
Total liabilities and shareholders' equity	**$7,330,694**	$6,706,995

†*Restated — see note 2.*

G. L. Henthorn, Vice-President & Comptroller

Consolidated Statement of Premium on Capital Stock

	(thousands of dollars)	
	Year 1977	Year 1976
Balance at beginning of year	**$ 460,878**	$441,213
Premium on common shares issued during the year	**66,265**	19,665
Balance at end of year	**$ 527,143**	$460,878

Consolidated Statement of Retained Earnings

	(thousands of dollars)	
	Year 1977	Year 1976†
Balance at beginning of year		
As previously reported	**$ 806,449**	$692,215
Prior years' adjustment (note 2)	**(1,699)**	(1,559)
As restated	**804,750**	690,656
Net income	**288,575**	289,572
Excess of par value over cost of preferred shares purchased for cancellation (note 9)	**66**	203
	1,093,391	980,431
Deduct:		
Dividends — Preferred shares	**31,534**	28,847
— Common shares	**175,626**	143,969
	207,160	172,816
Expenses of issues of capital stock	**3,694**	2,865
	210,854	175,681
Balance at end of year	**$ 882,537**	$804,750

†*Restated — see note 2.*

Consolidated Statement of Changes in Financial Position

	(thousands of dollars)	
	Year 1977	Year 1976†
Source of funds		
Operations —		
Income before extraordinary item	**$ 286,208**	$ 287,384
Items not affecting current funds —		
Depreciation	**480,620**	430,858
Deferred income taxes	**116,102**	93,011
Interest charged to construction	**(16,193)**	(15,559)
Other — net	**38,894**	33,462
Total from operations	**905,631**	829,156
Extraordinary item (note 5)	**2,367**	2,188
Proceeds from long term debt	**293,050**	279,965
Proceeds from issue of Bell Canada common shares upon exercise of warrants	**118,607**	763
Proceeds from preferred shares	**—**	68,248
Proceeds from issues of shares by subsidiaries to minority shareholders	**9,701**	11,748
Issue of common shares upon conversion of convertible preferred shares	**18,952**	34,655
Miscellaneous	**12,689**	32,539
Decrease in working capital	**36,939**	106,827
	$1,397,936	$1,366,089
Disposition of funds		
Capital expenditures —		
Gross capital expenditures	**$1,046,987**	$ 995,597
Deduct: charges not requiring funds	**(13,748)**	(26,064)
Increase (decrease) in material and supplies	**(2,296)**	26,351
Net expenditures	**1,030,943**	995,884
Dividends by Bell Canada	**207,160**	172,816
Dividends by subsidiaries to minority shareholders	**10,730**	8,600
Reduction of long term debt	**88,668**	116,780
Acquisition of investments	**34,348**	34,582
Conversion of preferred shares	**18,975**	34,684
Miscellaneous	**7,112**	2,743
	$1,397,936	$1,366,089
The increase (decrease) in working capital is accounted for by —		
Increase (decrease) in current assets:		
Cash and temporary cash investments	**$ (66,047)**	$ (2,010)
Accounts receivable	**86,382**	(6,116)
Inventories	**(2,003)**	(1,876)
Other	**4,533**	1,338
(Increase) decrease in current liabilities:		
Accounts payable	**(43,728)**	(63,020)
Advance billing for service	**(5,169)**	(4,797)
Dividends payable	**(6,680)**	(4,396)
Taxes accrued	**10,876**	23,683
Interest accrued	**(10,829)**	(6,493)
Debt due within one year	**(4,274)**	(43,140)
Decrease in working capital, as above	**$ (36,939)**	$ (106,827)

†*Restated — see note 2.*

Notes to Financial Statements

1. Accounting policies

The accompanying financial statements have been prepared in accordance with Canadian generally accepted accounting principles. With respect to Bell Canada and its subsidiary companies, the only important difference between Canadian and United States generally accepted accounting principles is in regard to the accounting for translation of foreign currency transactions and financial statements of foreign subsidiary companies as described in note 16.

Bell Canada and its telephone subsidiary and associated companies are subject to regulation, including examination of accounting practices, by their respective regulatory authorities. Bell Canada is regulated on the basis of its non-consolidated financial statements in which its investments in subsidiary and associated companies are carried at cost. The system of accounts and accounting practices are similar to those being used in the telecommunication industry.

Consolidation

The accounts of companies in which Bell Canada owns more than 50% of the outstanding common shares have been fully consolidated and the investments in associated companies (50% or less, and 20% or more) have been accounted for by the equity method. The associated companies of Bell Canada and its subsidiaries at December 31, 1977 were Maritime Telegraph & Telephone Company, Limited,(1) The New Brunswick Telephone Company, Limited, Telesat Canada, SOTEL INC., National Telephone Directory Corporation, Intersil, Inc. and Data 100 Corporation.

The companies in which Bell Canada had a direct investment of more than 50% of common shares at December 31, 1977 were:

	%
Northern Telecom Limited(2)	69.2
Newfoundland Telephone Company Limited	78.2
Northern Telephone Limited	99.8
Télébec Ltée	100
Lièvre Valley Telephone Company	100
The Capital Telephone Company Limited	100
The North American Telegraph Company	100
Bell Canada — International Management, Research and Consulting Ltd.	100

For companies acquired the excess of cost of shares over acquired equity is being amortized to earnings over periods not exceeding forty years. Such amortization amounted to $929,000 in 1977 ($645,000 - 1976).

Bell Canada's summarized income statement, balance sheet and statement of changes in financial position, on a non-consolidated basis, are presented on pages 32 to 34.

(1) At December 31, 1977, Bell Canada was the registered owner of 2,172,200 or 40.0% of the outstanding common shares of Maritime Telegraph & Telephone Company, Limited; however, under a statute passed by the Legislature of Nova Scotia, not more than 1,000 shares may be voted by any one shareholder.

(2) At December 31, 1977, Bell Canada was the beneficial owner of 18,304,334 or 69.2% (18,307,809 or 69.2% at December 31, 1976) of the outstanding common shares of Northern Telecom Limited. Assuming exercise of the warrants outstanding at December 31, 1977 the shareholding would be 61.6%. Each warrant entitles the holder to purchase from Bell Canada prior to December 1, 1979 one common share of Northern Telecom Limited at $21.50. At December 31, 1977, 1,991,834 common shares of Northern Telecom Limited were deposited in escrow with the Warrant Trustee for that purpose. In addition, assuming issuance of approximately 3,150,000 new common shares of Northern Telecom Limited on the acquisition, if completed, of Sycor, Inc., Bell Canada's shareholding in Northern Telecom Limited would be approximately 55.1%.

Sales revenues — manufacturing and distributing

	(thousands of dollars)	
	Year 1977	Year 1976
Sales to:		
Bell Canada	**$ 533,235**	$ 531,704
Telephone subsidiary and associated companies of Bell Canada	**52,046**	65,903
Sub-total	**585,281**	597,607
Sales to others	**656,170**	504,267
Total sales	**$1,241,451**	$1,101,874

Telecommunication equipment, purchased by Bell Canada and its telephone subsidiaries from Northern Telecom Limited and its subsidiaries, is reflected in the consolidated balance sheet at cost to the purchasing companies, and in the consolidated income statement is included in Sales revenues — manufacturing and distributing. To the extent that any income on these sales and those to associated companies has not been offset by depreciation or other operating expenses, it remains in consolidated retained earnings and consolidated income. This treatment is generally accepted in the industry. All other significant intercompany transactions have been eliminated in the accompanying consolidated financial statements.

Depreciation

Depreciation is computed on the straight line method using rates based on the estimated useful lives of the assets.

When depreciable telecommunication property is retired, the amount at which such property has been carried in telecommunication plant is charged to Accumulated depreciation.

Depreciation expense, including amortization of property held under capital leases, for the year ended December 31, 1977 was $480,620,000 ($430,858,000 — 1976) and the composite rate was 6.16% (6.15% — 1976).

Maintenance and repairs

The cost of maintenance and repairs of property is expensed as incurred.

Research and development

Research and development costs are charged to income in the years in which they are incurred.

Research and development expense for the year ended December 31, 1977 was $112,996,000 ($84,302,000 — 1976).

Translation of foreign currencies

The long term debt payable in U.S. funds is translated into Canadian funds at the exchange rate prevailing at the time the debt was incurred. The accounts of foreign subsidiary companies have been translated into Canadian dollars at exchange rates prevailing at the balance sheet dates for working capital items, at exchange rates prevailing at the respective transaction dates for non-current assets and liabilities (and related depreciation and amortization) and at average exchange rates prevailing during the years for income and expenses (see note 16).

Leases

Leases are classified as capital or operating leases. A lease that transfers substantially all of the benefits and risks incident to the ownership of property is classified as a capital lease. All other leases are accounted for as operating leases wherein rental payments are expensed as incurred. At the inception of a capital lease, an asset and an obligation are recorded at an amount equal to the lesser of the present value of the minimum lease payments and the property's fair value at the beginning of such lease. Assets recorded under capital leases are amortized on a straight line method using rates based on the estimated useful life of the asset or based on the lease term as appropriate. The obligation is reduced by rental payments net of imputed interest.

Inventories

Inventories held by the manufacturing and distributing subsidiaries are valued at the lower of cost (calculated generally on a first-in, first-out basis) and net realizable value. The cost of finished goods and work-in-process inventories comprises material, labour and manufacturing overhead.

Interest charged to construction

Regulatory authorities allow the telephone companies to provide for a return on capital invested in new telephone plant while under construction by including "interest charged to construction" as an item of income during the construction period and also as an addition to the cost of the plant constructed. Such income is not realized in cash currently but will be realized over the service life of the plant.

Income taxes

Bell Canada and all subsidiaries use the tax allocation basis of accounting for income taxes. Reductions in income taxes relating to losses carried forward in subsidiaries are not recorded in the accounts until the date of their realization.

Investment tax credit

The investment tax credit is included in the balance sheet as "Deferred credits — Other" and is being amortized by credits to income, as a reduction of income taxes, over the average estimated service life of telecommunication property.

2. Accounting change — leases

In 1977, Bell Canada and its subsidiaries changed their method of accounting for leases as described in note 1 — leases. This change resulted in an increase of consolidated net income of $282,000 in 1977. The effect on consolidated net income as reported in earlier years is a $1,699,000 decrease of which $140,000 is applicable to the year 1976. Prior period data have been restated to reflect this change in accounting.

3. Equity in net income of associated companies

Equity in net income of associated companies represents Bell Canada's share of net income of companies accounted for by the equity method. The dividends received from these companies amounted to $7,649,000 in 1977 ($7,164,000 — 1976).

4. Income taxes

A reconciliation of the statutory income tax rate in Canada to the effective income tax rate is as follows:

	Year 1977	Year 1976
Statutory income tax rate	**48.0%**	48.0%
i) Interest charged to construction, net of applicable depreciation adjustment	**(0.9)**	(0.9)
ii) Reduction of Canadian Federal taxes applicable to manufacturing profits	**(1.4)**	(1.2)
iii) Other miscellaneous differences between the calculation of taxable income and book income before taxes and outright reductions of taxes for the year resulting from various tax credits and grants	**(1.9)**	(1.5)
Effective income tax rate	**43.8%**	44.4%

Details of the Company's income taxes are as follows:

	(thousands of dollars)	
	Year 1977	Year 1976
Current	**$133,232**	$158,634
Deferred	**116,102**	93,011
Total income taxes	**$249,334**	$251,645

Deferred income taxes result from deductions for tax purposes, in respect of plant, being in excess of amounts currently charged to operations.

5. Extraordinary item

	(thousands of dollars)	
	Year 1977	Year 1976
Reduction on a consolidated basis, net of minority interest of $1,055,000 ($975,000 — 1976), of income taxes arising from the utilization of prior years' tax losses of a subsidiary of Northern Telecom Limited ($0.06 ($0.05 — 1976) per common share)	**$2,367**	$2,188

6. Earnings per common share

Earnings per common share are based on average shares outstanding.

For the computation of the earnings per share, assuming full conversion of convertible preferred shares and exercise of warrants, the dividends on convertible preferred shares have been added back to income. For 1976, the computation also includes the dilutive effect of warrants outstanding at December 31, 1976. These warrants, which were issued in October 1975 and exercisable at $46, expired on June 30, 1977, at which date 99.8% had been exercised.

7. Leases

"Telecommunication Property" and "Manufacturing and Distributing Property" include property recorded under capital leases as follows:

	(thousands of dollars)	
	December 31, 1977	December 31, 1976
Telecommunication Property:		
Buildings, plant and equipment	**$57,519**	$59,783
Less: Accumulated depreciation	**16,004**	14,253
	41,515	45,530
Land	**3,350**	3,350
	$44,865	$48,880
Manufacturing and Distributing Property:		
Buildings, plant and equipment	**$ 2,848**	$ 2,848
Less: Accumulated depreciation	**1,808**	1,504
	$ 1,040	$ 1,344

The future minimum lease payments under capital leases, and operating leases that have initial or remaining non-cancellable lease terms in excess of one year as of December 31, 1977 are as follows:

	(thousands of dollars)	
	Capital leases	Operating leases
1978	$ 10,845	$ 29,616
1979	11,127	27,270
1980	9,343	21,346
1981	8,992	16,164
1982	7,611	12,615
thereafter	106,327	62,369
Total future minimum lease payments	154,245	$169,380
Less: Estimated executory costs	52,191	
Net minimum lease payments	102,054	
Less: Imputed interest	52,626	
Present value of net minimum lease payments	$ 49,428	

Rental expense applicable to operating leases for the year 1977 was $78,805,000 ($67,877,000 — 1976).

Bell Canada has agreed to purchase a mortgage for a sum not to exceed $37,106,000 in the event of mortgage payment default by the owner of a building. In such event the future minimum lease payments included in capital leases above will be reduced by approximately $74,493,000.

8. Inventories

	(thousands of dollars)	
	December 31, 1977	December 31, 1976
Manufacturing and distributing —		
Raw materials	**$ 59,212**	$ 55,654
Work-in-process	**86,420**	84,810
Finished goods	**79,835**	87,006
	$225,467	$227,470

9. Capital stock

Authorized

By charter — $1,750,000,000 divided into common shares of the par value of $25 each, and into preferred shares.

By shareholders — $1,750,000,000 divided into common shares of the par value of $25 each, and: (a) not more than 2,000,000 of a class of preferred shares to a maximum aggregate amount of $94,000,000; (b) not more than 9,000,000 of another class of preferred shares to a maximum aggregate amount of $225,000,000; (c) not more than 7,000,000 of another class of preferred shares to a maximum aggregate amount of $219,000,000; and (d) not more than 8,000,000 of another class of preferred shares to a maximum aggregate amount of $200,000,000.

Changes in Bell Canada's issued capital stock during 1977 were as follows:

	Outstanding at January 1, 1977	Issued for cash	Conversion of preferred shares	Purchases of preferred shares for cancellation	Outstanding at December 31, 1977
	(dollars in thousands)				
Preferred shares					
Cumulative, redeemable, convertible and voting					
$3.20 shares (par value of $47 per share)					
Number	391,199	—	(143,422)	—	247,777
Total par value	$ 18,386	—	$ (6,741)	—	$ 11,645
$3.34 shares, class B, series B (par value of $52 per share)					
Number	449,632	—	(196,733)	—	252,899
Total par value	$ 23,381	—	$ (10,230)	—	$ 13,151
$4.23 shares, class C, series D (par value of $47 per share)					
Number	1,996,300	—	(41,105)	—	1,955,195
Total par value	$ 93,826	—	$ (1,932)	—	$ 91,894
$2.28 shares, class C, series E (par value of $25 per share)					
Number	4,999,762	—	(2,875)	—	4,996,887
Total par value	$ 124,994	—	$ (72)	—	$ 124,922
Cumulative, redeemable and voting					
$2.25 shares, class B, series C (par value of $30 per share)					
Number	1,547,000	—	—	(51,000)	1,496,000
Total par value	$ 46,410	—	—	$ (1,530)	$ 44,880
$1.80 shares, class B, series F (par value of $20 per share)					
Number	3,500,000	—	—	—	3,500,000
Total par value	$ 70,000	—	—	—	$ 70,000
Total par value of preferred shares	$ 376,997	—	$ (18,975)	$ (1,530)	$ 356,492
Common shares					
(par value of $25 per share)					
Number	40,620,341	2,755,362*	384,601	—	43,760,304
Total par value	$1,015,509	$ 68,884*	$ 9,615	—	$ 1,094,008

*The common shares issued for cash represent 152,699 shares purchased by employees through assignment of dividends under the provisions of the Employees' Savings Plan (1966) and 2,602,663 shares issued at $46 upon exercise of warrants. The excess of proceeds over par value amounting to $56,927,000 was allocated to Premium on capital stock.

The $3.20 preferred shares are currently redeemable, at Bell Canada's option, at $47 plus a premium of $2.50 to February 1, 1978, diminishing by $.50 at the end of each subsequent year to February 1, 1982, and thereafter at $47. Each $3.20 preferred share may be converted into one common share on or before February 1, 1982. At December 31, 1977, 1,752,223 of these shares had been converted (including 218,400 during 1976).

The $3.34 preferred shares, class B, series B, are currently redeemable, at Bell Canada's option, at $52 plus a premium of $3.00 to August 1, 1978, diminishing by $.50 at the end of each subsequent year to August 1, 1983, and thereafter at $52. The $3.34 preferred shares are convertible into common shares on or before August 1, 1983. Prior to October 22, 1975 they were convertible on a one for one basis; effective that date, the conversion ratio was changed to 1.012 common shares for each preferred share. At December 31, 1977, 1,747,101 of these shares had been converted (including 466,415 during 1976).

The $4.23 preferred shares, class C, series D, are not redeemable prior to December 1, 1980, but may be redeemed thereafter, at Bell Canada's option, at $47 plus a premium of $4.00 diminishing by $.70 at the end of each subsequent year to December 1, 1983, by $.60 at December 1, 1984, by $.70 at December 1, 1985, by $.60 at December 1, 1986, and thereafter at $47. Each $4.23 preferred share may be converted into one common share on or before December 1, 1986. At December 31, 1977, 44,805 of these shares had been converted (including 3,390 during 1976).

The $2.28 preferred shares, class C, series E, are not redeemable prior to July 2, 1981, but may be redeemed thereafter, at Bell Canada's option, at $25 plus a premium of $2.00 diminishing by $.35 at the end of each subsequent year to July 2, 1986, by $.25 at July 2, 1987, and thereafter at $25. Two $2.28 preferred shares may be converted into one common share on or before July 2, 1987. At December 31, 1977, 3,113 of these shares had been converted (including 238 during 1976).

The $2.25 preferred shares, class B, series C, are not redeemable prior to October 1, 1983, but may be redeemed thereafter, at Bell Canada's option, at $30 plus a premium of $1.50 diminishing by $.375 at the end of each subsequent five year period to October 1, 2003, and thereafter at $30. Pursuant to the conditions attaching to this issue of shares, at December 31, 1977, 204,000 shares with an aggregate par value of $6,120,000 had been purchased and cancelled (including 51,000 shares with an aggregate par value of $1,530,000 during 1976).

The $1.80 preferred shares, class B, series F, are not redeemable prior to October 2, 1986, but may be redeemed thereafter, at Bell Canada's option, at $20 plus a premium of $1.20 diminishing by $.30 at the end of each subsequent five year period to October 2, 2006, and thereafter at $20.

Common shares reserved at December 31, 1977 — 5,773,683

4,957,348 shares for issuance upon conversion of all convertible preferred shares.

66,335 shares for issuance under the Employees' Savings Plan (1966).

750,000 shares for issuance under the Shareholder Dividend Reinvestment and Stock Purchase Plan.

10. Long Term Debt

Bell Canada

	(thousands of dollars)				
First mortgage bonds	3¾ - 5¾ %	6 - 7⅞ %	8 - 9⅞ %	10 - 10½ %	Total outstanding December 31, 1977
1978	$ —	$ 70,000	$ —	$ —	$ 70,000
1979	40,000	—	70,000	—	110,000
1980	30,000	—	72,000	—	102,000
1981	24,000	28,500	—	—	52,500
1982	90,000	—	—	—	90,000
1983-1992	210,000	251,500	141,066	—	602,566
1993-2002	78,000	206,000	516,000	130,000	930,000
2003-2004	—	4,000	26,000	—	30,000
	472,000	560,000	825,066	130,000	1,987,066
Debentures 1986-2006	—	100,000	410,000	—	510,000

Exchange premium less discount, at time of issue, on debt payable in United States funds	
— First mortgage bonds	23,926
— Debentures	780
	2,521,772
Obligations under capital leases	48,258
Sub-total — Bell Canada	2,570,030
Subsidiaries (including $1,170 of obligations under capital leases)	188,316
Sub-total — consolidated	2,758,346
Less: due within one year	78,479
Total — consolidated	**$2,679,867**

— The first mortgage bonds of Bell Canada are secured by a first mortgage and a floating charge.

— At December 31, 1977, the long term debt of Bell Canada payable in United States funds was $928,000,000 comprising $50,000,000 of first mortgage bonds maturing in 1983, $518,000,000 maturing from 1988 to 2004 and $360,000,000 of debentures.

— Based on the exchange rate at December 31, 1977, the premiums on first mortgage bonds and on debentures would be $53,392,000 and $33,840,000, respectively.

— At December 31, 1977, the amounts of long term debt payable by Bell Canada and subsidiary companies in the years 1978 to 1982 are $78,479,000, $117,786,000, $113,706,000, $61,939,000 and $101,956,000, respectively.

11. Debt due within one year

	(thousands of dollars) December 31, 1977	1976
Long term debt	$ 78,479	$ 96,144
Notes payable	101,232	79,935
Bank advances	15,930	15,288
	$195,641	$191,367

It has been the practice for Bell Canada and telephone subsidiaries to employ as interim financing, pending long term financing, debt due in twelve months or less after issuance. In Bell Canada the computation of ratios of debt to total capitalization for regulatory and other purposes includes debt due within one year.

Additional data with regard to Notes payable

	(dollars in thousands) 1977	1976
i) Maximum amount outstanding at any month-end during the year ended December 31	$104,576	$115,359
ii) Average amount outstanding during the year ended December 31	$ 84,011	$ 90,167
iii) Weighted average annual interest rate during the year ended December 31	7.3%	8.7%
iv) Weighted average annual interest rate at December 31	7.2%	8.0%

12. Pensions

Bell Canada and most of its subsidiary companies have non-contributory plans which provide for service pensions based on length of service and rates of pay. The actuarial valuations as of December 31, 1975 indicated that all vested benefits were fully funded. The funding programs meet the requirements of Federal and Provincial laws.

The total provisions for the cost of pension plans were $132,349,000 for the year ended December 31, 1977 ($115,066,000 — 1976).

13. Remuneration of officers and directors

During the year 1977, Bell Canada's shareholders were served by 21 directors. As such, their aggregate remuneration from Bell Canada was $230,000. Some of them served also as directors of Northern Telecom Limited, and certain of its subsidiaries; as such their aggregate remuneration was $75,000 from these companies.

Bell Canada had 30 officers during 1977 and their aggregate remuneration as officers was $2,875,000. Two of the officers served also as directors of Bell Canada in 1977.

In addition, payments made by Bell Canada for the benefit of certain of its officers pursuant to special retirement plans amounted to $134,000 for 1977.

14. Canadian anti-inflation legislation

Anti-inflation legislation controlling increases in profit margins, prices, dividends and compensation became effective in Canada on October 14, 1975, and will be phased out beginning on April 14, 1978. Bell Canada and its Canadian subsidiaries are subject to this legislation.

Based on available information, management of Bell Canada is of the opinion that, in all respects material to Bell Canada and its Canadian subsidiaries, they are in compliance with the Anti-Inflation Act and regulations.

15. Quarterly financial data

Summarized consolidated quarterly financial data (in thousands of dollars except per share amounts) are as follows:

	Three months ended			
1977	March 31†	June 30†	September 30†	December 31
Total operating revenues	$533,376	$556,684	$604,816	$623,560
Net operating revenues	130,907	124,480	178,392	176,123
Sales revenues — manufacturing and distributing	302,310	335,695	290,073	313,373
Gross profit — manufacturing and distributing	83,141	99,868	89,562	94,615
Income before extraordinary item	62,083	60,907	83,591	79,627
Extraordinary item	400	420	484	1,063
Net income	62,483	61,327	84,075	80,690
Net income applicable to common shares	54,471	53,408	76,247	72,915
Earnings per common share before extraordinary item*	1.33	1.26	1.73	1.64
Assuming full conversion of convertible preferred shares and exercise of warrants	1.25	1.24	1.67	1.59
*Based on average common shares outstanding (thousands)	40,799	41,986	43,653	43,733

1976	March 31†	June 30†	September 30†	December 31†
Total operating revenues	$490,326	$508,436	$521,740	$536,182
Net operating revenues	145,106	142,501	147,313	142,385
Sales revenues — manufacturing and distributing	277,281	305,422	247,542	271,629
Gross profit — manufacturing and distributing	78,624	86,787	72,321	75,081
Income before extraordinary item	74,266	73,646	68,963	70,509
Extraordinary item	346	392	683	767
Net income	74,612	74,038	69,646	71,276
Net income applicable to common shares	67,559	67,078	62,813	63,275
Earnings per common share before extraordinary item*	1.69	1.67	1.55	1.54
Assuming full conversion of convertible preferred shares and exercise of warrants	1.55	1.54	1.44	1.44
*Based on average common shares outstanding (thousands)	39,815	39,930	40,196	40,476

† *Restated — see note 2.*

16. Translation of foreign currencies

Bell Canada and its Canadian subsidiaries follow the Canadian generally accepted practice of accounting for translation of foreign currency transactions and financial statements of foreign subsidiary companies (see note 1).

If the translation had been made in accordance with the United States Financial Accounting Standards Board's Statement No. 8: Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements, consolidated net income and earnings per common share would have increased (decreased) as follows:

	Increase (decrease) in consolidated net income (thousands of dollars)	Increase (decrease) in earnings per common share
Three months ended		
March 31, 1977	$(29,200)	$(0.72)
June 30, 1977	(2,700)	(0.06)
September 30, 1977	(10,700)	(0.25)
December 31, 1977	(13,400)	(0.31)
March 31, 1976	13,500	0.34
June 30, 1976	8,900	0.22
September 30, 1976	(1,400)	(0.03)
December 31, 1976	(23,200)	(0.57)
Year ended		
December 31, 1977	(56,000)	(1.32)
December 31, 1976	(2,200)	(0.05)

17. Industry segment information

In accordance with the United States Financial Accounting Standards Board's Statement No. 14, information about the Company's operations in different industry segments for the twelve months ended December 31, 1977

and as at December 31, 1977 is presented below:

		(millions of dollars)			
	Telecommunications services	Telecommunications equipment manufacturing	Other	Elimi-nations	Consoli-dated
Operating and sales revenues	$2,319	$1,064(b)	$177(b)	$ —	$3,560
Intersegment sales	—	27	86	(113)	—
Total revenues	$2,319	$1,091	$263	$(113)	$3,560
Total net revenues	$ 610	$ 202	$ 8	$(1)	$ 819(c)
Equity in net income of associated companies	$ 12	$ —	$ 1	$ —	13
Other income					30
Interest charges					(222)
General corporate expenses					(71)
Income before income taxes, minority interest and extraordinary item					$ 569
Identifiable assets at December 31, 1977	$6,435	$ 563	$104	$(66)	$7,036(d)
Investment in net assets of associated companies	$ 113	$ —	$ 31	$ —	144
General corporate assets					151(d)
Total assets at December 31, 1977					$7,331
Depreciation	$ 449	$ 24	$ 6	$ —	$ 479
Depreciation — general corporate assets					2
					$ 481
Capital expenditures	$1,005	$ 37	$ 8	$(4)	$1,046
Capital expenditures — general corporate assets					1
					$1,047

(a) Bell Canada and its subsidiary and associated companies operate principally in two industries:

i) Telecommunications services, which include the provision of voice, visual, data, radio and television transmission, public exchange and private line teletypewriter and other telecommunication services. Bell Canada and its telephone subsidiary and associated companies are subject to regulation by their respective regulatory authorities.

ii) Telecommunications equipment manufacturing, which involves the production and sale of central office switching equipment, subscriber apparatus, business communications systems, transmission equipment and wire and cable.

(b) Telecommunications equipment manufacturing and Other sales revenues include sales of $581 million and $4 million, respectively, to Bell Canada, its telephone subsidiary and associated companies. These sales are not eliminated on consolidation (see note 1 — *Consolidation*). Telecommunications equipment manufacturing sales of Northern Telecom Limited to Bell Canada are at prices and terms as low as those offered to Northern Telecom Limited's most favored customers for like materials and services under comparable conditions.

(c) Total net revenues of $748 million as shown in the Consolidated Income Statement are after deducting expenses of $71 million applicable to Telecommunications equipment manufacturing and Other segments which are shown as general corporate expenses.

(d) Identifiable assets by industry segment are those assets that are used in each segment's operation. Corporate assets are principally cash and temporary cash investments.

(e) Over 90% of the Company's sales are derived from operations located in Canada and are to customers in Canada.

18. Replacement cost data (unaudited)

The Company has developed estimates of the replacement cost of the productive capacity represented by its plant investment. Inventories, depreciation expense and cost of sales (manufacturing and distributing) have also been estimated on the basis of replacement cost. These estimates have been prepared in compliance with rules and guidelines issued by the United States Securities and Exchange Commission.

	(millions of dollars)			
	December 31, 1977		December 31, 1976†	
	Historic cost	At estimated replacement cost	Historic cost	At estimated replacement cost
Telecommunication property:				
Subject to replacement cost disclosure	$8,171	$12,220	$7,324	$10,489
Land and plant under construction, included at historic cost	269	269	306	306
	8,440	12,489	7,630	10,795
Less: Accumulated depreciation	2,372	4,316	2,110	3,608
	6,068	8,173	5,520	7,187
Manufacturing and distributing property:				
Subject to replacement cost disclosure	360	708	336	659
Land and other property, included at historic cost	39	39	35	35
	399	747	371	694
Less: Accumulated depreciation	209	439	195	396
	190	308	176	298
Net plant investment	$6,258	$ 8,481	$5,696	$ 7,485
Inventories	$ 225	$ 232	$ 227	$ 235

Replacement cost of productive capacity and inventories

The replacement cost data presented above is an estimate of the cost that would be incurred if the productive capacity and inventories were replaced at cost levels existing at December 31, 1977 and December 31, 1976 respectively. Land and plant under construction are not revalued but are included at historic cost.

The Company recommends caution in interpreting the significance of the difference between replacement cost and historic cost for the following reasons:

i) The estimates are based on the assumed replacement of productive capacity at December 31, 1977 and December 31, 1976, respectively, using a mix of technology appropriate to business conditions existing at those dates.

Actual replacement will take place over many years, using a mix of technology appropriate to business conditions existing at those future dates.

ii) The establishment of the estimates involves numerous assumptions and therefore the result must be recognized as only an indication of the replacement cost of productive capacity.

Depreciation expense and cost of sales (manufacturing and distributing)

The Company has estimated the depreciation charge which would be required if the average depreciable plant for the year were valued at its replacement cost, and the cost of sales (manufacturing and distributing) on the basis of replacement cost. These estimates are presented below.

Bell Canada stresses that it would be incorrect to assume that net income as reported in the historic cost financial statements can be adjusted by the additional depreciation expense of $191 million ($167 million — 1976) to produce a more meaningful measure of income. The major portion of the increase in cost of sales (manufacturing and distributing) is due to the increase in depreciation expense. In addition to these adjustments, the following factors would have to be considered:

i) The estimates do not cover all assets, liabilities, revenues and expenses and therefore the estimates are incomplete. The effects of these additional elements would have to be included in the measurement of income.

ii) The estimates of replacement cost assume a mix of plant and technology which is different from the plant in place. If the assumed plant and technology were in place, operating and maintenance cost savings would be realized and additional revenues would probably be generated since the newer plant has greater service capabilities. In the opinion of management, such cost savings and additional revenues would be significant in total. It is, however, not possible at this time to estimate them with reasonable accuracy.

These factors together with others such as the cost of additional financing, if necessary, and income tax considerations, make it misleading to recalculate net income.

	(millions of dollars)			
	Year 1977		Year 1976†	
	Historic cost	At estimated replacement cost	Historic cost	At estimated replacement cost
Depreciation expense:				
Telecommunication property	$449	$628	$404	$559
Manufacturing and distributing property	32	44	27	39
	$481	$672	$431	$598
Cost of sales (manufacturing and distributing)	$874	$891	$789	$807

Replacement cost estimation procedures

In the case of telecommunication property where there have been significant technological improvements, the Company assumed that productive capacity would be replaced with the most modern technology that could be justified in terms of the foreseen demand for the services. For this reason, latest technology was not assumed to replace all existing capacity.

The specific method used to develop replacement cost data was tailored to the characteristics of the assets being evaluated, as follows:

Central office equipment — current acquisition cost of equipment used to meet currently foreseen demand. The equipment replacement pattern that was assumed provides for slightly more than half of Bell Canada's subscribers to be served by the most technically advanced electronic switching systems, as opposed to slightly more than 14% (10% — 1976) that are currently served in this manner.

Outside plant — current construction cost per conductor mile.

Station equipment — current acquisition cost per unit.

Buildings — current construction cost per square foot of space.

Tools and vehicles — current acquisition cost per unit.

In the case of manufacturing and distributing property, replacement costs were estimated by using current acquisition costs or indices specifically developed for several major categories. Present business conditions, current technology and the Company's normal approach to replacement of capacity were assumed.

Replacement cost of inventories was estimated to reflect current cost of material, labour and expense.

Both the historic and the replacement cost data include assets held under capital leases as defined in note 1 of the Notes to the Financial Statements.

Depreciation expense was estimated based on the average replacement cost for the year of the depreciable assets. The depreciation charge was calculated on a straight line basis, using the same useful lives for the assets as is used in the historic cost financial statements. Cost of sales (manufacturing and distributing) was estimated on the basis of replacement cost by adjusting historic cost for the increase in costs between the time of manufacture and the time of sale.

†*Restated — see note 2*

19. Reclassification

Certain figures of 1976 have been reclassified to conform with the presentation adopted in the current year.

20. Subsequent events

a) On January 5, 1978, Bell Canada sold U.S. $200,000,000, principal amount of 9% Debentures, series DE, due 2008 for an aggregate sum of U.S. $198,250,000.

b) On December 14, 1977, the government of the Kingdom of Saudi Arabia announced its decision to award a contract for the extension, modernization, operation and maintenance of the Saudi Arabian Telephone system to a consortium consisting of Bell Canada, Philips of the Netherlands and L. M. Ericsson of Sweden. On January 25, 1978, Bell Canada signed a separate five-year contract, having an estimated value of 3.4 billion Saudi Riyals, equivalent to approximately $1.1 billion, with the Ministry of Posts, Telegraphs and Telephones of the Kingdom of Saudi Arabia for the operation and maintenance of the telephone system in the Kingdom and for the construction of certain facilities and the procurement of specific materials and supplies relative to this telephone system, principally motor vehicles and a computer.

Bell Canada will require extensive supporting services in Saudi Arabia in connection with its performance of this contract, and for this purpose has retained established business concerns in Saudi Arabia to provide such services. These concerns will be compensated by Bell Canada in amounts aggregating approximately 8% of the gross proceeds of the contract.

For purposes of the contract signed with the Ministry, Bell Canada furnished to the Kingdom of Saudi Arabia a performance guarantee of 168.4 million Saudi Riyals equivalent to approximately $53 million.

Subsequent to the signing of the contract, Bell Canada has received an advance payment of 673.5 million Saudi Riyals, equivalent to approximately $211 million.

This advance will be applied against gross payments due to Bell Canada over the life of the contract. Bell Canada has furnished an additional guarantee in an amount which will be equal to the balance of the advance payment.

At December 31, 1977 one Saudi Riyal was equivalent to approximately Can. $0.3131.

Bell Canada

Summarized Income Statement — Non-Consolidated (Note 1)

	(thousands of dollars)	
	Year 1977	Year 1976†
Operating revenues		
Local service	**$1,107,640**	$ 990,259
Long distance service	**970,453**	867,679
Miscellaneous — net	**55,322**	45,986
Total operating revenues	**2,133,415**	1,903,924
Operating expenses	**1,572,495**	1,367,677
Net operating revenues	**560,920**	536,247
Other income		
Dividends — from subsidiary companies	**19,637**	18,172
— from associated companies	**7,362**	6,971
Interest charged to construction	**15,683**	14,734
Miscellaneous	**10,279**	25,350
Total other income	**52,961**	65,227
Income before underlisted items	**613,881**	601,474
Interest charges	**202,393**	177,285
Income before income taxes	**411,488**	424,189
Income taxes	**178,593**	185,696
Net income	**232,895**	238,493
Dividends on preferred shares	**31,534**	28,847
Net income applicable to common shares	**$ 201,361**	$ 209,646
Earnings per common share*	**$4.73**	$5.23
Assuming full conversion of convertible preferred shares and, for 1976, exercise of warrants	**$4.68**	$4.96
Dividends declared per common share	**$4.08**	$3.58
*Based on average common shares outstanding (thousands)	**42,554**	40,106

†*Restated to reflect change in accounting for leases.*

Summarized Balance Sheet — Non-Consolidated (Note 1)

	(thousands of dollars)	
	December 31 1977	December 31 1976†
Assets		
Telecommunication property — at cost		
Buildings, plant and equipment	**$7,691,786**	$6,875,569
Less: Accumulated depreciation	**2,266,382**	2,013,466
	5,425,404	4,862,103
Land, and plant under construction	**254,875**	295,610
Material and supplies	**97,190**	100,424
	5,777,469	5,258,137
Investments — at cost		
Subsidiary companies	**212,431**	215,563
Associated companies	**107,971**	107,971
	320,402	323,534
Current assets	**287,910**	346,223
Deferred charges	**37,623**	28,295
Total assets	**$6,423,404**	$5,956,189
Liabilities and shareholders' equity		
Shareholders' equity		
Capital stock		
Preferred shares	**$ 356,492**	$ 376,997
Common shares	**1,094,008**	1,015,509
Premium on capital stock	**527,143**	460,878
Retained earnings	**682,748**	658,213
	2,660,391	2,511,597
Long term debt	**2,497,159**	2,314,259
Current liabilities	**485,190**	455,191
Deferred credits		
Income taxes	**758,969**	656,204
Other	**21,695**	18,938
	780,664	675,142
Total liabilities and shareholders' equity	**$6,423,404**	$5,956,189

†*Restated to reflect change in accounting for leases.*

Summarized Statement of Changes in Financial Position Non-Consolidated (Note 1)

	(thousands of dollars)	
	Year 1977	Year 1976†
Source of funds		
Operations		
Net income	**$ 232,895**	$ 238,493
Items not affecting current funds —		
Depreciation	**427,853**	385,410
Interest charged to construction	**(15,683)**	(14,734)
Other — net	**110,020**	94,438
Total from operations	**755,085**	703,607
Proceeds from long term debt	**255,204**	251,663
Proceeds from issue of Bell Canada common shares upon exercise of warrants	**118,607**	763
Proceeds from preferred shares	**—**	68,248
Issue of common shares upon conversion of convertible preferred shares	**18,952**	34,655
Miscellaneous	**17,356**	11,608
Decrease in working capital	**88,312**	137,453
	$1,253,516	$1,207,997
Disposition of funds		
Capital expenditures —		
Gross capital expenditures	**$ 951,079**	$ 901,324
Deduct: charges not requiring funds	**(14,703)**	(25,221)
Increase (decrease) in material and supplies	**(3,234)**	27,567
Net expenditures	**933,142**	903,670
Dividends	**207,160**	172,816
Reduction of long term debt	**76,604**	93,145
Acquisition of investments	**3,545**	1,670
Conversion of preferred shares	**18,975**	34,684
Miscellaneous	**14,090**	2,012
	$1,253,516	$1,207,997

†*Restated to reflect change in accounting for leases.*

Auditors' Report

The Shareholders, Bell Canada

We have examined the consolidated balance sheets of Bell Canada as at December 31, 1977 and 1976 and the consolidated statements of income, retained earnings, premium on capital stock and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1977 and 1976 and the results of its operations and the changes in its financial position for the years then ended in accordance with Canadian generally accepted accounting principles applied (after giving retroactive effect to the change, which we approve, in the method of accounting for leases as referred to in note 2) on a consistent basis.

Touche Ross & Co.
Chartered Accountants

Montreal, Que.
February 15, 1978

Summary of Operations

	(thousands of dollars) Year ended December 31,				
	1977	1976†	1975†	1974†	1973†
Operating revenues	**$2,318,436**	$2,056,684	$1,790,971	$1,549,457	$1,364,158
Operating expenses	**1,708,534**	1,479,379	1,264,480	1,087,919	936,781
Net operating revenues	**609,902**	577,305	526,491	461,538	427,377
Sales revenues — manufacturing and distributing	**1,241,451**	1,101,874	1,020,715	972,226	613,772
Cost of sales	**874,265**	789,061	738,133	720,765	452,996
Selling, general, administrative and other expenses	**229,079**	183,582	155,504	144,299	99,278
Net sales revenues	**138,107**	129,231	127,078	107,162	61,498
Total net revenues	**748,009**	706,536	653,569	568,700	488,875
Other income	**42,690**	56,560	38,258	29,743	27,467
Income before underlisted items	**790,699**	763,096	691,827	598,443	516,342
Interest charges	**221,825**	196,296	179,860	148,035	129,279
Income taxes	**249,334**	251,645	232,064	224,040	190,503
Minority interest	**33,332**	27,771	13,441	2,235	(3,135)
	504,491	475,712	425,365	374,310	316,647
Income before extraordinary items	**286,208**	287,384	266,462	224,133	199,695
Extraordinary items	**2,367(a)**	2,188(a)	50,578(b)	—	5,396
Net income	**288,575**	289,572	317,040	224,133	205,091
Dividends on preferred shares	**31,534**	28,847	24,845	17,594	14,020
Net income applicable to common shares	**$ 257,041**	$ 260,725	$ 292,195	$ 206,539	$ 191,071
Earnings per common share*					
— before extraordinary items	**$5.98**	$6.45	$6.19	$5.56	$5.03
— extraordinary items	**$0.06**	$0.05	$1.30	—	$0.14
— after extraordinary items	**$6.04**	$6.50	$7.49	$5.56	$5.17
Assuming full conversion of convertible preferred shares and for 1976 and 1975 exercise of warrants					
— before extraordinary items	**$5.80**	$5.97	$5.87	$5.34	$4.86
— extraordinary items	**$0.05**	$0.04	$1.12	—	$0.13
— after extraordinary items	**$5.85**	$6.01	$6.99	$5.34	$4.99
Dividends declared per common share	**$4.08**	$3.58	$3.44	$3.12	$2.85
* Based on average common shares outstanding (thousands)	**42,554**	40,106	38,998	37,128	36,931

The effect on sales, consolidated net income and earnings per common share(1) resulting from the discontinuation in 1975 of the semiconductor business of a subsidiary of Northern Telecom Limited is as follows:

	1975	1974	1973
Sales — manufacturing and distributing			
Continuing operations	$1,015,865	$948,514	$597,821
Discontinued operations	4,850	23,712	15,951
	$1,020,715	$972,226	$613,772
Consolidated income			
Continuing operations	$ 267,983	$231,698	$205,711
Discontinued operations	(3,950)	(7,565)	(6,016)
Extraordinary items	53,007	—	5,396
Net income	$ 317,040	$224,133	$205,091
Earnings per common share(1)			
Continuing operations	$ 5.90	$ 5.52	$ 5.01
Discontinued operations	$(0.09)	$(0.18)	$(0.15)
Extraordinary items	$ 1.18	—	$ 0.13
	$ 6.99	$ 5.34	$ 4.99

(1) Assuming full conversion of convertible preferred shares and exercise of warrants.

† *Restated — see note 2.*

(a) Utilization of prior years' tax losses of a subsidiary.

(b) Consolidated gain of $53,007,000 from the sale by Bell Canada of common shares of Northern Telecom Limited less provision of $2,429,000 for the costs of terminating the semiconductor business of a subsidiary of Northern Telecom Limited.

Management's Discussion and Analysis of Summary of Operations

Operating revenues
Operating revenues rose $261.8 million or 12.7% in 1977 and $265.7 million or 14.8% in 1976, reflecting the effect of rate awards and increased demand for local and long distance telecommunication services. The lower percentage increase in 1977 as compared to the previous year reflects the lower rate of growth for demand in telecommunication services throughout the year, as a result of the slow rate of growth of the Canadian economy.

Bell Canada received rate awards effective August 1975, January 1976 and June 1977, which have been estimated at approximately $31 million, $71 million and $152 million, respectively on an annualized basis. The impact of the June 1977 rate award in the year 1977 is estimated at approximately $85 million. Application for a further rate increase was filed by Bell Canada on February 1, 1978.

The number of long distance messages increased to approximately 588 million in 1977, from 556 million in 1976, and 517 million in 1975, or increases of 5.8% in 1977 and 7.5% in 1976. Miscellaneous revenues increased $25.7 million or 23.5% in 1977 and $23.8 million or 27.7% in 1976 reflecting primarily increased revenues from directory operations.

Operating expenses
Operating expenses increased $229.2 million or 15.5% in 1977 and $214.9 million or 17.0% in 1976. Approximately half of these increases were employee-related expenses (salaries, pensions and other benefits) which have increased as a result of higher wage rates and growth in the business. In addition, demand for telecommunication services necessitated increases in investment in depreciable plant in service (percentage increases were 11.8% in 1977 and 11.5% in 1976) which resulted in increased depreciation of $45.1 million or 11.2% in 1977 and $47.1 million or 13.2% in 1976.

Maintenance expense increased $65.8 million or 20.2% in 1977 and $38.1 million or 13.2% in 1976 primarily because of higher wage rates coupled with increased work volumes.

Net sales revenues — manufacturing and distributing
Sales revenues rose $139.6 million or 12.7% in 1977. Of this increase, $80.5 million was attributable to higher U.S. sales resulting primarily from the contribution ($38.5 million) of Cook Electric Company, acquired in December 1976, and higher volume, principally SL-1* business communications systems. Sales attributable to manufacturing operations outside North America accounted for $27.7 million of the increase. Total Canadian sales increased $31.4 million despite a $10.9 million decline in distribution sales. The volume of manufacturing sales in Canada was relatively flat primarily because of the slow growth of the Canadian economy.

In 1976, total sales revenues increased $81.2 million or 8.0% from 1975. This increase was due principally to higher prices and to higher volumes of switching, cable and subscriber equipment products, somewhat offset by lower volume of transmission products.

Costs of sales increased $85.2 million in 1977 or 10.8% and $50.9 million in 1976 or 6.9%. These increases were mainly attributable to increased sales and to the impact of inflation on the costs of purchased materials, labour and overhead. Productivity improvement programs and price increases offset the above factors and improved gross profits expressed as a percentage of sales from 27.7% in 1975 to 28.4% in 1976 and 29.6% in 1977. The 1977 gross profit was adversely affected by the deferral in Canada of price increases from February 1 to April 1, 1977 under an agreement with the Canadian Federal Anti-Inflation Board.

Selling, general and administrative expenses of $160.6 million in 1977 increased to 12.9% of sales from $121.8 million in 1976 or 11.1% of sales and from $104.7 million in 1975 or 10.3% of sales. These increases were mainly attributable, in order of relative importance, to higher compensation and benefit costs and expansion of the sales and marketing organization particularly in the U.S. Also, Cook Electric's expenses added $7.7 million in 1977.

Other expenses, mainly research and development expenses related to manufacturing operations, were $68.5 million in 1977 compared to $61.8 million in 1976 and $50.8 million in 1975, or increases of $6.7 million in 1977 and $11 million in 1976. These increases reflect Northern Telecom Limited's development program for digital and semiconductor technologies and the repeal in 1976 of the Canadian Industrial Research and Development Incentives Act under which Northern Telecom Limited received $4.4 million in 1975.

* Denotes Trademark

Other income
Other income decreased by $13.9 million in 1977 compared to 1976. This decrease is primarily due to lower interest income resulting mainly from a decrease in temporary cash investments. Other income increased by $18.3 million in 1976 compared to 1975, primarily because of higher interest income resulting mainly from increased temporary cash investments.

Interest charges
Interest charges increased 13.0% in 1977 and 9.1% in 1976, due to interest expense on additional debt issued to finance part of the capital expenditures and, to a lesser extent, the effect of refunding matured debt at higher interest rates. Also contributing to the increase in 1977 was the higher rate of exchange on interest payable in U.S. funds. The average embedded cost of debt (on a consolidated basis) was 7.9% in 1977 compared to 7.6% in 1976 and 7.4% in 1975.

Minority interest
Minority interest increased $5.6 million in 1977 and $14.3 million in 1976. The 1977 increase is primarily attributable to higher consolidated earnings of Northern Telecom Limited. The major contributing factor for the 1976 increase was the sale by Bell Canada in October 1975 of approximately 20% of the outstanding common shares of Northern Telecom Limited by way of a public offering, coupled with increased consolidated earnings of Northern Telecom Limited.

Extraordinary items
The extraordinary gains of $2.4 million in 1977 and $2.2 million in 1976 represent a reduction of income taxes arising from the utilization of prior years' tax losses of a subsidiary. In 1975, Bell Canada realized an extraordinary gain, net of income taxes of $14 million, of approximately $53 million (on a consolidated basis) from the sale of 5,250,000 common shares of Northern Telecom Limited. In 1975, there was also an extraordinary loss of $2.4 million, net of income taxes and minority interest, representing a provision for costs of terminating the semiconductor business of a subsidiary.

Price Ranges and Dividends Paid — Common and Preferred Shares

Price Ranges (a)

	1st Quarter		2nd Quarter		3rd Quarter		4th Quarter	
	High	Low	High	Low	High	Low	High	Low
1977								
Common (b)	$49⅜	$46⅜	$53⅛	$48⅜	$56	$52⅝	$56⅝	$52⅝
$3.20 Preferred	$49	$47½	$52⅜	$48⅞	$55¼	$53	$56⅛	$52⅞
$3.34 Preferred	49⅝	47	53	48¾	56½	53⅛	56¼	53
$4.23 Preferred	50⅞	48½	54⅝	49¾	57	53½	56½	53¾
$2.28 Preferred	27⅜	26	29	26½	29⅞	28⅛	30¼	29⅛
$2.25 Preferred	26¾	25¼	29⅜	26¾	30½	28⅝	30½	29½
$1.80 Preferred	21¼	20⅛	23	20⅝	23⅝	22½	23¾	22⅜
1976								
Common	$47¼	$42⅞	$48⅛	$44¾	$51⅛	$47⅛	$50⅜	$44⅞
$3.20 Preferred	$47	$43	$47¾	$45¼	$51	$47⅛	$50	$45¾
$3.34 Preferred	47¼	44¼	48⅛	45	51	47⅜	50⅝	45⅜
$4.23 Preferred	50½	47⅝	50½	48⅜	52⅜	49½	52½	46¾
$2.28 Preferred	27	25½	27⅛	25½	27½	26	28	24⅞
$2.25 Preferred	26	24¼	26	24¼	26	25	26¼	24¼
$1.80 Preferred	—	—	—	—	—	—	20¾	19⅜

Dividends Paid

Common Shares

1977	$0.93	$1.02	$1.02	$1.02
1976	$0.86	$0.86	$0.86	$0.93

Preferred Shares

The indicated rates are annual rates and dividends have been paid quarterly since dates of issue.

(a) The table shows market prices on the Toronto Stock Exchange. The common and preferred shares are also listed on the Montreal and Vancouver Stock Exchanges in Canada. The common shares are also listed on the Stock Exchanges of Amsterdam, Basle, Brussels, Dusseldorf, Frankfurt am Main, Geneva, London, New York, Paris and Zurich.

(b) Bell Canada common shares have been listed on the New York Stock Exchange since August 18, 1976. High and low prices (U.S. dollars) were $53⅛ and $45¼, respectively, during the year ended December 31, 1977.

Officers*

Chairman of the Board and Chief Executive Officer
A. Jean de Grandpré, Q.C.

President
James C. Thackray

Executive Vice-Presidents
J. V. Raymond Cyr
Quebec Region
Frederick E. Ibey
Operations
Gordon E. Inns
Ontario Region
Orland Tropea
Administration

Vice-Presidents
Wilfred D. E. Anderson
Operations Development
Harry Bowler
Finance
J. Robert Brûlé
Operations Staff, Quebec Region
Robert W. Crowley
Toronto Area
Claude Duhamel
Administration, Quebec Region
John H. Farrell
Regulatory Matters
Charles A. Harris
Public and Environmental Affairs
George L. Henthorn
Comptroller
W. Brian Hewat
Operations Performance
John A. McCutcheon
Marketing and Development
Andrew M. McMahon
Computer Communications
Léonce Montambault
Montreal Area
Harry Pilkington
Personnel
Hubert A. Roth
North/East Area
Claude St-Onge
Quebec Provincial Area
John E. Sinclair
Systems
John E. Skinner
Administration, Ontario Region
R. Douglas Sloane
Business Development and Network Services
John F. Stinson
Operations Staff, Ontario Region
Robert N. Washburn
South/West Area

General Counsel
Guy Houle

Secretary
James T. Moore

Treasurer
J. Stuart Spalding

*as at December 31, 1977

Directors

W. M. Vacy Ash, O.C.
Toronto, Ontario
Company Director
Board member since March 10, 1966
Resigned April 19, 1977

Marcel Bélanger, O.C., C.A.
Quebec, Quebec
Partner, Bélanger, Dallaire,
Gagnon & Associés
Board member since March 20, 1969

G. Allan Burton, D.S.O., E.D.
Milton, Ontario
Chairman of the Board and
Chief Executive Officer,
Simpsons, Limited
Board member since May 23, 1974

A. Jean de Grandpré, Q.C.
Outremont, Quebec
Chairman of the Board and
Chief Executive Officer,
Bell Canada
Board member since July 26, 1972

J. Douglas Gibson, O.B.E.
Toronto, Ontario
Chairman of the Board,
The Consumers' Gas Company
Board member since March 25, 1970

H. Clifford Hatch
Windsor, Ontario
President and Chief Executive Officer,
Hiram Walker-Gooderham & Worts Limited
Board member since April 9, 1974

Helen S. Hogg, C.C.
Richmond Hill, Ontario
Professor Emeritus,
University of Toronto
Board member since March 21, 1968

James W. Kerr
Toronto, Ontario
Chairman and Chief Executive Officer,
TransCanada PipeLines Limited
Board member since August 26, 1970

Paul H. Leman, O.C.
Outremont, Quebec
Vice-Chairman of the Board,
Alcan Aluminium Limited
Board member since April 20, 1976

John C. Lobb
Singer Island, Florida
Chairman, John C. Lobb &
Associates, Inc.
Board member since October 24, 1973
Resigned December 31, 1977

E. Neil McKelvey, Q.C.
Saint John, New Brunswick
Partner, McKelvey, Macaulay,
Machum & Fairweather
Board member since April 3, 1973

John H. Moore
London, Ontario
Chairman of the Board,
Brascan Limited
Board member since March 10, 1966

J. Dean Muncaster
Toronto, Ontario
President, Canadian Tire Corporation,
Limited
Board member since April 19, 1977

Gérard Plourde
Montreal, Quebec
Chairman of the Board and
Chief Executive Officer,
U A P Inc.
Board member since January 1, 1973

Louis Rasminsky, C.C., C.B.E.
Ottawa, Ontario
Company Director
Board member since September 26, 1973

The Hon. John P. Robarts, P.C., C.C., Q.C.
Toronto, Ontario
Member of Stikeman, Elliott,
Robarts & Bowman
Board member since June 23, 1971

H. Rocke Robertson, C.C., M.D.
Mountain, Ontario
Company Director
Board member since July 8, 1965

Lucien G. Rolland
Westmount, Quebec
President and General Manager,
Rolland Paper Company, Limited
Board member since July 8, 1965

Robert C. Scrivener
Montreal, Quebec
Chairman of the Board and
Chief Executive Officer,
Northern Telecom Limited
Board member since November 1, 1967

James C. Thackray
Westmount, Quebec
President, Bell Canada
Board member since April 20, 1976

Louise Brais Vaillancourt
Outremont, Quebec
Company Director
Board member since January 1, 1975

Committees of the Board of Directors*

Executive Committee
A. J. de Grandpré — Chairman
P. H. Leman
J. H. Moore
G. Plourde
L. Rasminsky
H. R. Robertson
R. C. Scrivener
J. C. Thackray

Audit Committee
M. Bélanger — Chairman
H. C. Hatch
E. N. McKelvey
J. H. Moore
L. B. Vaillancourt

Management Resources and Compensation Committee
J. W. Kerr — Chairman
M. Bélanger
G. A. Burton
J. D. Gibson
H. C. Hatch

Pension Fund Policy Committee
L. G. Rolland — Chairman
J. D. Gibson
J. C. Lobb
E. N. McKelvey
J. D. Muncaster
L. Rasminsky
J. P. Robarts

Social and Environmental Affairs Committee
H. S. Hogg — Chairman
A. J. de Grandpré
J. P. Robarts
H. R. Robertson
J. C. Thackray
L. B. Vaillancourt

* as at December 31, 1977

Statistical Summary

Bell Canada — Consolidated Data	1977	1976	1975	1974	1973
Income Statement Items (thousands of dollars)†					
Operating revenues	**$2,318,436**	$2,056,684	$1,790,971	$1,549,457	$1,364,158
Sales revenues — manufacturing and distributing	**1,241,451**	1,101,874	1,020,715	972,226	613,772
Income before extraordinary items	**286,208**	287,384	266,462	224,133	199,695
Net income	**288,575**	289,572	317,040	224,133	205,091
Preferred dividends	**31,534**	28,847	24,845	17,594	14,020
Net income applicable to common shares	**257,041**	260,725	292,195	206,539	191,071
Balance Sheet Items (thousands of dollars)†					
Total property — net*	**$6,258,569**	$5,695,904	$5,122,117	$4,630,081	$4,088,948
Preferred equity*	**356,492**	376,997	343,211	332,002	248,988
Common equity*	**2,518,978**	2,296,427	2,141,251	1,869,444	1,767,388
Minority interest*	**195,457**	161,143	128,315	42,440	42,314
Long term debt* (including current portion)	**2,758,346**	2,567,328	2,371,617	2,227,107	1,953,311
Capital expenditures	**1,046,987**	995,597	901,923	882,064	616,615
Common Share Data†					
Earnings per common share					
— before extraordinary items	**$5.98**	$6.45	$6.19	$5.56	$5.03
— after extraordinary items	**$6.04**	$6.50	$7.49	$5.56	$5.17
Assuming full conversion of convertible preferred shares and exercise of warrants (1)					
— before extraordinary items	**$5.80**	$5.97	$5.87	$5.34	$4.86
— after extraordinary items	**$5.85**	$6.01	$6.99	$5.34	$4.99
Dividends per common share	**$4.08**	$3.58	$3.44	$3.12	$2.85
Equity per common share*	**$57.56**	$56.53	$53.85	$50.07	$47.77
Average common shares outstanding (thousands)	**42,554**	40,106	38,998	37,128	36,931
Per cent of common shares held in Canada*	**93.9**	96.7	97.9	96.0	96.0
Number of shareholders (including preferred)*	**221,224**	225,457	231,689	230,630	237,458

Bell Canada — Non-Consolidated Data	1977	1976	1975	1974	1973
Income Statement Items (thousands of dollars)†					
Operating revenues	**$2,133,415**	$1,903,924	$1,665,870	$1,440,123	$1,275,204
Operating expenses	**1,572,495**	1,367,677	1,171,624	1,007,256	872,979
Other income	**52,961**	65,227	53,340	44,630	39,278
Interest charges	**202,393**	177,285	160,934	131,688	116,805
Income taxes	**178,593**	185,696	173,918	160,802	149,468
Income before extraordinary items	**232,895**	238,493	212,734	185,007	175,230
Net income	**232,895**	238,493	305,331	185,007	180,626
Per cent return on total capital†	**8.4**	8.7	8.5	8.0	7.9
Interest in per cent of total average debt†	**7.8**	7.5	7.3	6.8	6.5
Times interest charges earned†	**3.0**	3.4	3.4	3.6	3.8
Balance Sheet Items (thousands of dollars)†					
Telecommunication property — net*	**$5,777,469**	$5,258,137	$4,732,242	$4,280,357	$3,794,873
Investments*	**320,402**	323,534	323,011	343,819	319,674
Preferred equity*	**356,492**	376,997	343,211	332,002	248,988
Common equity*	**2,303,899**	2,134,600	2,029,390	1,768,302	1,704,877
Long term debt* (including current portion)	**2,570,030**	2,407,133	2,215,095	2,034,094	1,813,498
Capital expenditures	**951,079**	901,324	815,679	794,109	554,699
Other Statistics					
Telephones in service*	**8,620,229**	8,301,433	7,888,581	7,518,505	7,102,308
Local conversations (thousands)	**11,522,437**	11,064,275	10,560,102	10,390,353	9,849,738
Long distance messages (thousands)	**557,210**	527,919	490,627	448,438	395,851
Number of employees*	**50,350**	48,133	44,904	46,484	43,033
Salary and wage payments (thousands of dollars)	**$756,339**	$646,379	$561,232	$487,116	$421,841

(1)For 1976 and 1975 exercise of warrants
*At December 31
†Years 1973 to 1976 have been restated — see note 2

Bell
Canada

TransCanada Telephone System

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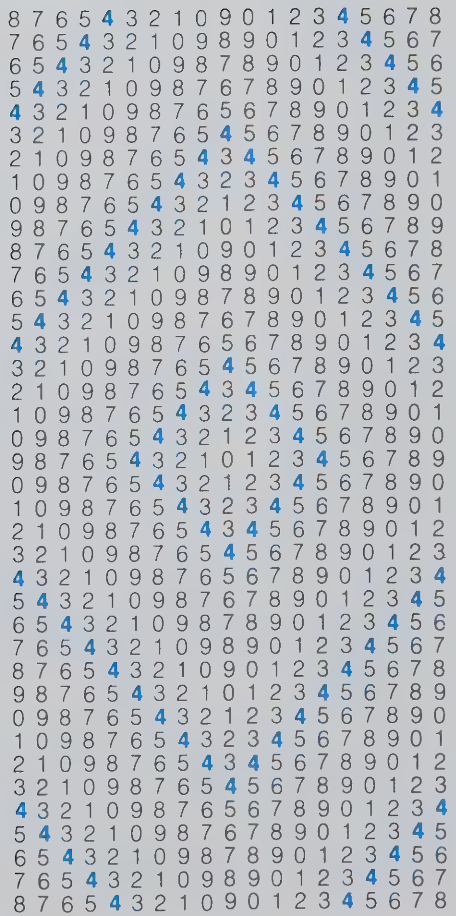
Bell Canada

1977 Year-end Report to the Shareholders



Financial Highlights

Bell Canada and Subsidiary Companies — Consolidated

	Three months ended December 31		Twelve months ended December 31	
	1977	1976†	1977	1976†
Earnings per common share	$1.67	$1.56	$6.04	$6.50
Total revenues (thousands of dollars)	$936,933	$807,811	$3,559,887	$3,158,558
Net income (thousands of dollars)	$ 80,690	$ 71,276	$ 288,575	$ 289,572

(Details of consolidated financial results are contained in the accompanying statements of Income and Changes in Financial Position)

Bell Canada — Non-consolidated (Regulated)

	Three months 1977	Three months 1976†	Twelve months 1977	Twelve months 1976†
Earnings per common share	$1.39	$1.24	$4.73	$5.23
Operating revenues (thousands of dollars)	$574,016	$494,807	$2,133,415	$1,903,924
Net income (thousands of dollars)	$ 68,596	$ 58,095	$ 232,895	$ 238,493
Capital expenditures (thousands of dollars)	$240,583	$258,616	$ 951,079	$ 901,324
Return on average common equity	10.60%	9.43%	9.02%	10.06%

†Restated

Financial Results

Canada's business climate throughout 1977 was characterized by a weak economy and political uncertainty — factors which adversely affected most Canadian businesses, including Bell Canada.

Bell Canada's 1977 consolidated earnings per common share at $6.04 were $0.46 lower than in 1976. Net income applicable to common shares decreased and the number of common shares outstanding increased.

Earnings of Bell Canada, the regulated telephone company, were $4.73 per common share in 1977, compared to $5.23 in 1976, mainly as a result of a slowing in the growth rate of long distance and local service revenues throughout the year.

The non-consolidated return on average common equity for 1977 was 9.02 per cent, well below the 12 per cent level the regulators have deemed acceptable.

On February 1, 1978, the Company applied to the Canadian Radio-television and Telecommunications Commission for approval of increased rates and of a higher permissive level of earnings in 1979 in the range of 13.5 to 14.5 per cent, which the Company believes is necessary to prudently finance the business. The Company asked for approval to implement the increased rates on July 15, 1978 in order to earn a 12 per cent return on average common equity in 1978.

Bell Canada

TransCanada Telephone System

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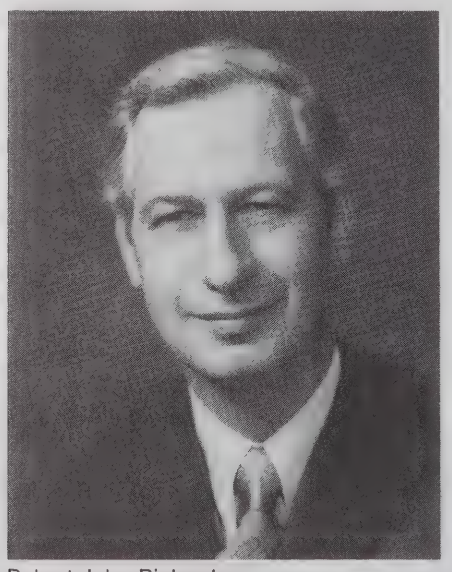
Bell Canada and Subsidiary Companies
Consolidated Statement of Changes in Financial Position (subject to audit)

	(thousands of dollars) Twelve months ended December 31	
	1977	1976†
Source of funds		
Operations —		
Income before extraordinary item	$ 286,208	$ 287,384
Items not affecting current funds —		
Depreciation	480,620	430,858
Deferred income taxes	116,102	93,011
Interest charged to construction	(16,193)	(15,559)
Other — net	38,894	33,462
Total from operations	905,631	829,156
Extraordinary item	2,367	2,188
Proceeds from long term debt	293,050	279,965
Proceeds from issue of Bell Canada common shares upon exercise of warrants	118,607	763
Proceeds from preferred shares	—	68,248
Proceeds from issues of shares by subsidiaries to minority shareholders	9,701	11,748
Issue of common shares upon conversion of convertible preferred shares	18,952	34,655
Miscellaneous	12,689	32,539
Decrease in working capital	36,939	106,827
	$1,397,936	$1,366,089
Disposition of funds		
Capital expenditures —		
Gross capital expenditures	$1,046,987	$ 995,597
Deduct: charges not requiring funds	(13,748)	(26,064)
Increase (decrease) in material and supplies	(2,296)	26,351
Net expenditures	1,030,943	995,884
Dividends by Bell Canada	207,160	172,816
Dividends by subsidiaries to minority shareholders	10,730	8,600
Reduction of long term debt	88,668	116,780
Acquisition of investments	34,348	34,582
Conversion of preferred shares	18,975	34,684
Miscellaneous	7,112	2,743
	$1,397,936	$1,366,089

† Restated to reflect change in accounting for leases.

Annual Meeting

The Annual General Meeting of the Shareholders will take place, beginning at 2:00 p.m., Tuesday, April 18, 1978 at Hamilton Place, Hamilton, Ontario. The 1977 Annual Report, Notice and Information Circular, proxy material and Annual Meeting admission card will be mailed to shareholders beginning March 10.



Robert John Richardson

New Director

In December, the Company announced the appointment of Robert John Richardson, Sc. D., of Greenville, Delaware to the Board of Directors, effective January 1, 1978. Dr. Richardson, a Canadian citizen and native of North Bay, Ontario, is Chairman of Du Pont of Canada and Vice-President — Finance of E. I. du Pont de Nemours & Company of Wilmington, Delaware. He was appointed to fill the Board vacancy created by the retirement of John C. Lobb, former Chairman of Northern Telecom Inc.

Finance

In December, the Company announced its intention to issue debentures in the United States market and, in early January, U.S. $200 million were issued at par at an interest rate of nine per cent. The issue, Series DE, will mature January 15, 2008.

Saudi Arabia Contract

The government of the Kingdom of Saudi Arabia announced in December its decision to award a multi-billion dollar contract for extending its telephone network to a consortium of companies comprising Bell Canada, Philips of the Netherlands and L. M. Ericsson of Sweden.

The combined undertaking is believed to be the largest-ever single telecommunications project. Bell Canada's share of the gross proceeds will be more than a billion dollars over a five-year period and the project is expected to generate some 500 new jobs for Canadians.

A. J. de Grandpré, Chairman
February 3, 1978

Bell Canada

TransCanada Telephone System

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Bell Canada and Subsidiary Companies
Consolidated Income Statement (subject to audit)

	(thousands of dollars)			
	Three months ended December 31		Twelve months ended December 31	
	1977	1976†	1977	1976†
Operating revenues	$623,560	$536,182	$2,318,436	$2,056,684
Operating expenses	447,437	393,797	1,708,534	1,479,379
Net operating revenues	176,123	142,385	609,902	577,305
Sales revenues — manufacturing and distributing	313,373	271,629	1,241,451	1,101,874
Cost of sales and expenses	279,766	242,850	1,103,344	972,643
Net sales revenues	33,607	28,779	138,107	129,231
Total net revenues	209,730	171,164	748,009	706,536
Other income (charges)				
Interest charged to construction	3,621	4,363	16,193	15,559
Equity in net income of associated companies	4,090	3,190	13,094	11,705
Miscellaneous	(1,779)	8,791	13,403	29,296
Income before underlisted items	215,662	187,508	790,699	763,096
Interest charges	57,279	50,735	221,825	196,296
Income taxes	69,754	59,278	249,334	251,645
Minority interest	9,002	6,986	33,332	27,771
	136,035	116,999	504,491	475,712
Income before extraordinary item	79,627	70,509	286,208	287,384
Extraordinary item(1)	1,063	767	2,367	2,188
Net income	80,690	71,276	288,575	289,572
Dividends on preferred shares	7,775	8,001	31,534	28,847
Net income applicable to common shares	$ 72,915	$ 63,275	$ 257,041	$ 260,725
Earnings per common share*				
— before extraordinary item	$1.64	$1.54	$5.98	$6.45
— extraordinary item	$0.03	$0.02	$0.06	$0.05
— after extraordinary item	$1.67	$1.56	$6.04	$6.50
Assuming full conversion of convertible preferred shares and for 1976 exercise of warrants				
— before extraordinary item	$1.59	$1.44	$5.80	$5.97
— extraordinary item	$0.02	$0.01	$0.05	$0.04
— after extraordinary item	$1.61	$1.45	$5.85	$6.01
Dividends declared per common share	$1.02	$0.93	$4.08	$3.58
*Based on average common shares outstanding (thousands)	43,733	40,476	42,554	40,106

(1) Reduction of income taxes arising from the utilization of prior years' tax losses of a subsidiary of Northern Telecom Limited after deducting minority interest of $474,000 ($342,000-1976) for the three month period and $1,055,000 ($975,000-1976) for the twelve month period.

† Restated to reflect change in accounting for leases.

G. L. Henthorn, *Vice-President & Comptroller*

Bell Canada and Subsidiary Companies
Consolidated Statement of Changes in Financial Position (subject to audit)

	(thousands of dollars) Twelve months ended December 31	
	1977	1976†
Source of funds		
Operations —		
Income before extraordinary item	$ 286,208	$ 287,384
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Miscellaneous	7,112	2,743
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† Restated to reflect change in accounting for leases.

Bell Canada

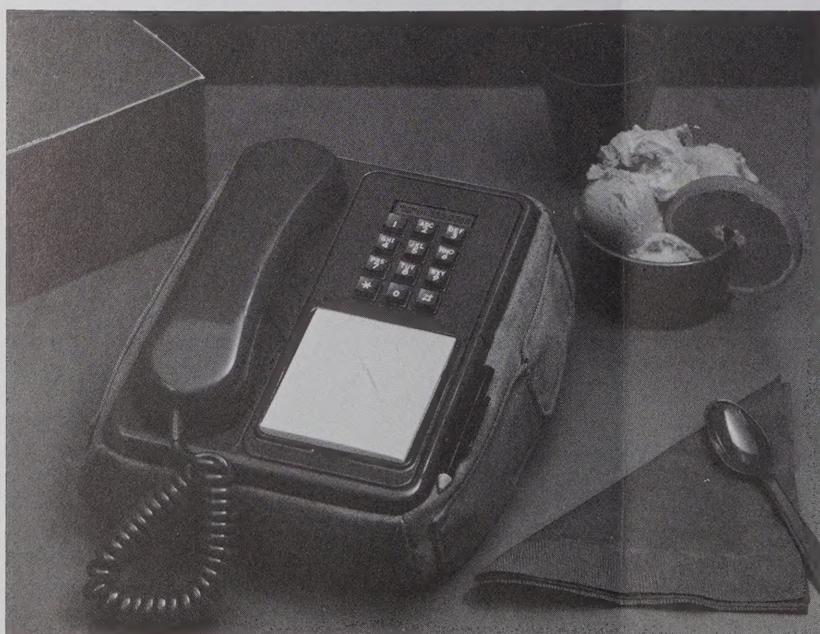
TransCanada

New Telephones

In December, Bell Canada began marketing a stylish new line of telephones designed by Bell-Northern Research and manufactured by Northern Telecom. These models are available from Bell Canada's Phone Centres and Téléboutiques, located in various Ontario and Quebec communities.

New Telephones

In December, Bell Canada began marketing a stylish new line of telephones designed by Bell-Northern Research and manufactured by Northern Telecom. These models are available from Bell Canada's Phone Centres and Téléboutiques, located in various Ontario and Quebec communities.



Bell
Canada

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